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Ju 11. 7/2:1986-176

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T. C. Memo. 1986-176

UNITED STATES TAX COURT

RICHARD D. RUNION, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 2917-84. Filed April 29, 1986.

Richard D. Runion, pro se.

Gloria Gooding, for the respondent.

MEMORANDUM OPINION

DRENNEN, Judge: This case was assigned to Special Trial Judge Helen A. Buckley pursuant to section 7456 of the Code[1] and

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[1] Section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

Rules 180 and 183 of the Tax Court Rules of Practice and Procedure. The Court agrees with and adopts her opinion which is set forth below.

OPINION OF THE SPECIAL TRIAL JUDGE

BUCKLEY, Special Trial Judge: This case presents yet another instance of abuse of the processes of this Court. Respondent determined a deficiency in petitioner's 1980 Federal income tax in the amount of $12,183, together with additions to tax under section 6651(a) of $2,406.50, under section 6653(a) of $609.15 and under section 6654(a) of $572.59. Petitioner timely filed his petition to this Court. He then was, and is, a resident of Huntington Beach, California.

Petitioner filed a form petition, substantially identical with those filed by several hundred other persons in California.[2] The petition contains allegations of a tax protestor nature. Thus, petitioner alleged that he was not required to file an income tax return or pay an income tax for 1980, that he was not a taxpayer, that he received nothing during those years of known tangible value, that he enjoyed no grant of privilege or franchise and that he did not volunteer to self-assess himself for taxes. Petitioner filed a request for a jury trial which was denied; he filed a motion for summary judgment that was denied.

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[2] We take judicial notice of this fact. See, e.g., Africa v. Commissioner, T.C. Memo. 1984-95; Dragoun v. Commissioner, T.C. Memo. 1984-94; Urban v. Commissioner, T.C. Memo. 1984-85; Ross v. Commissioner, T.C. Memo. 1983-624; Langseth v. Commissioner, T.C. Memo. 1983-576, to cite but a few of the cases considered.

The deficiency determination was based upon petitioner's failure to report $35,341 in income from wages received by him as follows:

Catalytic, Inc.	$ 2,272
Biggs Drayage	16,131
Babcock Wilcox	9,360
Scott Buttner	3,476
Westinghouse	4,102

Petitioner agreed that he worked for the five companies so listed, he admitted that he received compensation for his labor in the amounts shown on the notice of deficiency. He also admitted that he did not file a tax return for 1980.

Petitioner was advised at the call of the calendar that compensation for services constituted an element of gross income, that he was required to file a return and that our income tax system is not voluntary. He was advised not to pursue the frivolous arguments set forth in his petition. The Court ascertained that he had been given a copy of the opinions of this Court in Rowlee v. Commissioner, 80 T.C. 1111 (1983), and Cleveland v. Commissioner, T.C. Memo. 1985-209, and petitioner admitted at trial that he had read the two cases. He nevertheless continued with his various frivolous tax protestor arguments ad absurdum. We have discussed the law at length in Rowlee and many other cases.

As we stated in Cleveland:

> We would do a disservice to those taxpayers who have brought to this Court genuine controversies with respondent were we to devote time to any extended discussion of the

> lack of merit to petitioner's arguments. McCoy v. Commissioner, 76 T.C. 1027, 1029 (1981), affd. 696 F.2d 1234 (9th Cir. 1983).

We decline to restate that which has been so long settled and we hold for respondent in regard to the deficiency and the additions to tax. Petitioner's arguments are completely groundless and frivolous and he knew that they were. Petitioner at trial stated that he had at all times faithfully tried to obey the laws of the United States of America. He made this statement after reading Rowlee and Cleveland, and he then proceeded once again with his protestor arguments. Petitioner did not strike this Court as an unintelligent person. We can therefore only conclude that he had no intention of obeying the internal revenue laws of this country, that he was intent upon wasting the time and energy of this Court and that he filed and maintained his petition primarily for purposes of delay. Accordingly, we award damages of $5,000 to the United States under the provisions of section 6673 for the filing of a frivolous petition and maintaining such position primarily for purposes of delay.

Decision will be entered
for the respondent.

Ju 11.7/2: 1986-177

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T. C. Memo. 1986-177

UNITED STATES TAX COURT

MICHAEL A. KOZMA, Petitioner v. COMMISSIONER
OF INTERNAL REVENUE, Respondent

Docket No. 34727-84. Filed April 29, 1986.

John S. Regan, for the petitioner.

David W. Elston, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

PARR, Judge: Respondent determined deficiencies in petitioner's income tax in the amounts of $1,434.56 and $2,146.00 for the years 1980 and 1981, respectively. The issue for decision is whether respondent was correct in treating the ordinary and necessary expenses relating to petitioner's gambling

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business as part of his "losses from wagering transactions", for purposes of limiting under section 165(d)[1] the amount of such losses in excess of petitioner's gross income from gambling.

FINDINGS OF FACT

This case was submitted to the Court without trial pursuant to Rule 122. The facts have been stipulated and are so found. The stipulation of facts and related exhibits are incorporated herein by this reference.

At the time of filing the petition in this case, petitioner resided in Flint, Mich. He timely filed income tax returns for the years 1980 and 1981.

During 1980 and 1981, the years at issue, petitioner was an ironworker by trade. He was also in the trade or business of gambling. Petitioner attached a Schedule C [Profit (or Loss) from Business or Profession] to his 1980 and 1981 income tax returns showing losses from his gambling activities.

For 1980, petitioner's Schedule C showed gross receipts of $9,750.00, and cost of goods sold and/or operations of $9,506.00. Those amounts represented petitioner's gross gambling winnings[2] and the amounts he paid for wagering tickets, respectively. The gross profit was therefore $244.00. Petitioner then listed various deductions totalling $3,468.00, subtracted this amount from gross profit, and arrived at a loss of $3,224.00.

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] The parties' stipulation of facts states that these amounts represented petitioner's gross gambling winnings and "gambling consulting fees received." There is no explanation of the nature or amount of "consulting" income, and respondent does not urge any treatment of that income other than the treatment accorded
(footnote continued)

For 1981, petitioner's Schedule C showed gross receipts of $15,191.00, cost of goods sold and/or operations of $14,085.00, and a gross profit of $1,106.00. His deductions totalled $8,148.00, leaving a loss of $7,042.00.

In both years, the deductions listed on the Schedule C were not for amounts spent for wagering tickets, but were business expenses such as car expenses, depreciation, meals and lodging, admission fees, and office supplies. The amounts and the reasonableness of these business expenses are not challenged by respondent.

In his notice of deficiency, respondent disallowed petitioner's loss of $3,224.00 for 1980 and $7,042.00 for 1981. Respondent stated that since gambling losses are allowable only to the extent of gambling winnings under section 165, such losses are not allowable. Respondent determined deficiencies in petitioner's income tax for those years based on this disallowance and various other automatic adjustments to items

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(footnote continued from previous page)
actual gambling winnings. Therefore, we treat the full amounts shown as gambling winnings.

which are determined with reference to adjusted gross income.

OPINION

Respondent's determination of deficiencies is based on section 165(d), which reads, "Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions." Since petitioner's "cost of goods sold and/or operations" combined with his deductions for business expenses resulted in losses, respondent disallowed those losses for 1980 and 1981.

Petitioner does not contest that losses from wagering transactions may be deducted only to the extent of gains from wagering transactions, but maintains that his losses from wagering transactions did not exceed his gains. Petitioner's position is that his gambling losses in 1980 and 1981 were the amounts listed as "cost of goods sold and/or operations," and these amounts did not exceed his gross receipts, which were gambling gains. While in each taxable year, petitioner showed a loss from his gambling business, such loss was due to deductions for ordinary and necessary business expenses under section 162,[3] and was not limited by section 165(d).

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[3] Sec. 162(a) provides, in part:

> There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

The issue thus comes down to the proper computation of what section 165(d) refers to as "losses from wagering transactions." Under respondent's approach, those losses include both amounts paid for losing bets and petitioner's trade or business expenses. Petitioner, on the other hand, considers losses from wagering transactions to be his losing wagers alone. His position is that the trade or business expenses are deductible in any event, even if the end result is a loss from his gambling business.

Petitioner's position is that a "wagering transaction" means a specific event with a beginning and an end, such as a horse race, rather than an ongoing business. However, respondent's position is supported by settled case law, both from this Court and at least one Court of Appeals. We decline to overrule those precedents,[4] and hold for respondent.

In Offutt v. Commissioner, 16 T.C. 1214 (1951), a Court reviewed opinion, we approved the interpretation urged by respondent in this case. The taxpayer was a professional gambler and bookmaker. We held that he could not carry over or carry back his wagering losses to offset gambling income in other years; nor could he use such losses to offset nongambling income in the same year. Part of the wagering losses involved there consisted of mailing, printing, and stenographic expenses, which would ordinarily have qualified as regular trade or business expenses. Such expenses were thus not treated as separate deductions in the computation of wagering losses and gains, but were included in the "losses from wagering transactions."

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[4] We are reminded of the words of Justice Brandeis in Di Santo v. Pennsylvania, 273 U.S. 34, 42 (1927): "It is usually more important that a rule of law be settled, than that it be settled right."

The First Circuit has also approved this approach. In *Estate of Todisco v. Commissioner*, 757 F.2d 1 (1st Cir. 1985), affg. on this issue a Memorandum Opinion of this Court, the First Circuit held that state income taxes attributable to a bookmaker's wagering income were subject to the section 165(d) limitations on deductibility.

Although these two cases are the only instances where this precise issue has been decided, other cases have discussed the interplay between sections 162 and 165(d). It is well settled that a specific statute controls over a more general one. *Bulova Watch Co. v. United States*, 365 U.S. 753, 758 (1961); *United States v. Bates*, 429 F.2d 557, 559 (9th Cir. 1970), cert. denied 400 U.S. 831 (1970). That principle has been applied to the relationship between section 162, a general statute, and section 165(d), a specific one. *Boyd v. United States*, 762 F.2d 1369, 1372 (9th Cir. 1985); *Nitzberg v. Commissioner*, 580 F.2d 357, 358 (9th Cir. 1978), revg. two Memorandum Opinions of this Court. In those cases, the Ninth Circuit held that a professional gambler and casino, respectively, could not deduct their wagering losses as business expenses under section 162. Such losses were governed by the more specific statute, section 165(d). Although we are dealing with a different issue in this case, that statement is relevant in this context as well.

Moreover, if petitioner's view were adopted and his trade or business expenses allowed in excess of his gambling gains, this would give rise to a net operating loss from gambling. Again, the law is clear that a taxpayer cannot use a net operating loss from gambling to offset income from other sources, nor can such a loss be carried over or back to another tax year. *Offutt v. Commissioner*, *supra*; *Skeeles v. United States*, 95 F.Supp. 242 (Ct. Cl. 1951), cert. denied 341 U.S. 948 (1951); *Gordon v. Commissioner*, 63 T.C. 51 (1974), modified on other issues, 63 T.C. 501 (1975), affd. in part and revd. in part 572 F.2d 193 (9th Cir. 1977), cert. denied 435 U.S. 924 (1978).

In conclusion, we hold that respondent was correct in disallowing petitioner's deductions for his gambling business expenses to the extent they would create a loss from gambling. Such deductions were properly added to the amounts spent on losing bets in arriving at "losses from wagering transactions" which, under section 165(d), may only be deducted to the extent of gains from such transaction.

Decision will be
entered for respondent.

Ju 11.7/2: 1986-178

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T. C. Memo. 1986-178

UNITED STATES TAX COURT

HARRY H. ENNIS and VIRGINIA ENNIS, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 6894-84. Filed April 29, 1986.

W. Kevin Jackson, for the petitioners.

James B. Ausenbaugh, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SWIFT, Judge: In a statutory notice dated December 15, 1983, respondent determined a deficiency in petitioners' 1981 Federal income tax liability in the amount of $37,670. Following concessions, the issue remaining for decision is whether petitioners suffered a theft loss deductible under section 165(c)(3).[1]

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as in effect during the taxable year in issue, and all rule references are to the Tax Court Rules of Practice and Procedure.

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FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The pertinent facts, insofar as they appear in the record herein, are set forth below.

Petitioners, Harry H. and Virginia Ennis, are husband and wife and reside in Salt Lake City, Utah. Petitioners filed a timely joint Federal income tax return for 1981. Harry H. Ennis, hereinafter referred to as petitioner, is a physician and surgeon, and was employed by the Obstetrics and Gynecology Clinic, Inc., of Salt Lake City, Utah, during 1981. Virginia Ennis is a petitioner in this action solely because she joined with her husband in filing a joint Federal income tax return for 1981.

The present controversy arises out of petitioner's financial support of a mutual life insurance company known as TMT Mutual Life Company ("TMT Mutual"). In 1976, petitioner was approached by the president and promoter of TMT Mutual, Thomas M. Tebbs ("Tebbs"). Tebbs was the sole proprietor of an insurance agency known as T. M. Tebbs Co. Tebbs told petitioner that he intended to form a mutual life insurance company (namely, TMT Mutual) and that he needed a substantial sum of money to satisfy certain statutory requirements of the State of Utah before the Commissioner of Insurance of the State of Utah would issue a permit for TMT Mutual to operate as an insurance company. Tebbs indicated to petitioner that he already had obtained investments in the proposed venture from five or six other individuals and that he expected the new company to be profitable. Tebbs told petitioner and other potential investors that they would receive certificates of contribution from TMT Mutual to evidence their loans to or investments in the company. Although Tebbs apparently did not have a solicitation permit required by Utah State law,[2] he solicited petitioner for a loan to TMT Mutual of $100,000. Petitioner told Tebbs that he only had $8,000 available for the investment, and on March 4, 1977, petitioner transferred $8,000 to TMT Mutual as a loan.

On April 12, 1977, Tebbs obtained a personal short-term loan from Walker Bank and Trust Company ("Walker Bank") in the amount of $55,000 for use in connection with the business of TMT Mutual. The stated interest rate on the loan was 8.5 percent per year, with a due date of July 11, 1977. The loan proceeds apparently were to be reloaned by Tebbs to TMT Mutual. From the loan proceeds, $50,000 was placed in a depository or escrow account on behalf of TMT Mutual on April 15, 1977, under an agreement between TMT Mutual, the Utah State Insurance Commissioner, and Walker Bank. Such an escrow account was required by Utah law[3] before permission could be obtained from the Utah Commissioner of Insurance to establish an insurance company.

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[2] Utah Code Ann. § 31-6-3 (1974), requires that any person forming or proposing to form an insurance company must first obtain a solicitation permit from the Utah Commissioner of Insurance prior to soliciting or receiving any funds and that any person in violation of this section shall be guilty of a felony.

[3] See Utah Code Ann. § 31-5-2.5 (1974).

TMT Mutual filed Articles of Incorporation with the State of Utah on April 15, 1977. On that same day, a Certificate of Authority was issued to TMT Mutual by the Utah Commissioner of Insurance allowing it to do business as an insurance company.

On April 26, 1977, Tebbs personally borrowed an additional $20,000 from Walker Bank in connection with the start up of TMT Mutual. The stated interest rate on that loan was 8.5 percent per year and the due date was October 25, 1977. The purpose of that loan, as stated on the bank's loan report, was for "interim working capital" for TMT Mutual. On September 1, 1977, Tebbs also refinanced in his own name the Walker Bank $55,000 loan he had obtained on April 12, 1977.

On October 4, 1977, Tebbs personally obtained a $12,000 loan from Valley Bank and Trust Company ("Valley Bank"). The $12,000 proceeds from this loan were to be reloaned by Tebbs to TMT Mutual and were to be used by TMT Mutual as additional working capital. Petitioner added his personal endorsement to the $12,000 promissory note to Valley Bank.

On or about December 30, 1977, petitioner and Tebbs jointly applied for and received an $80,000 loan from Walker Bank to refinance the two loans totaling $75,000 that Tebbs originally had received from Walker Bank in April of 1977. By December of 1977, Walker Bank apparently had become concerned about the credit worthiness of Tebbs and required petitioner's co-signature on the $80,000 promissory note of Tebbs.

Although TMT was to issue certificates of contribution to investors who loaned money to TMT Mutual, no such certificates were issued. TMT never issued any insurance policies, nor did it ever transact any business apart from the loan transactions mentioned above.

On February 27, 1978, Tebbs, on behalf of TMT Mutual, wrote a letter to the Utah Insurance Commissioner requesting permission to withdraw from the escrow account of TMT Mutual at Walker Bank the $50,000 deposited therein. In that letter, Tebbs represented, among other things, that TMT Mutual had not issued any insurance policies, had no liabilities outstanding against it, and that the funds to be withdrawn were to be used for "other business purposes." On March 1, 1978, the Utah Insurance Commissioner responded to Tebbs' letter, indicating that the $50,000 would be released upon receipt of TMT Mutual's Certificate of Authority. On March 8, 1978, upon receipt of TMT Mutual's Certificate of Authority and after authorization by the Utah Insurance Commissioner, the $50,000 in the escrow account was paid by Walker Bank to TMT Mutual. Tebbs endorsed the $50,000 cashier's check TMT Mutual received from Walker Bank and deposited the entire $50,000 into his wife's personal bank account.

An officer of Walker Bank contacted petitioner prior to release of the $50,000 from the TMT Mutual escrow account. Petitioner agreed to the release of the $50,000, having been previously told by Tebbs that the $50,000 would be applied to reduce the $80,000 debt to Walker Bank. When petitioner learned that the $50,000 was deposited into Tebbs' wife's personal bank account and was not used to pay down the $80,000 debt, petitioner confronted Tebbs. Apparently to placate petitioner, Tebbs, on September 30, 1978, signed four promissory notes payable to petitioner, each in the amount of $20,000.

On August 21, 1979, Tebbs, aka T.M. Tebbs Company and T.M. Agency (a sole proprietorship), filed a bankruptcy petition in the United States District Court for the Central District of Utah. TMT Mutual was not a party to the bankruptcy proceeding. Petitioner filed a proof of claim in the bankruptcy proceeding based on the four $20,000 promissory notes Tebbs gave him on September 30, 1978, but petitioner did not assert in the bankruptcy proceeding that the debts of Tebbs reflected by those four promissory notes were not dischargeable in bankruptcy due to the fraud or illegal acts of Tebbs, nor did petitioner allege therein that he had been robbed or defrauded by Tebbs. On June 12, 1981, an order was entered in the bankruptcy proceeding discharging Tebbs from the liabilities set forth in the bankruptcy petition. Petitioner did not receive anything on his claim. TMT Mutual was involuntarily dissolved by the State of Utah on December 31, 1979, for failure to file annual reports.

Petitioner was called upon to pay the $12,000 promissory note of Tebbs to Valley Bank because of his endorsement of the note. He made that payment on November 17, 1980. Petitioner also was called upon to pay $71,000 to Walker Bank, which was the balance due on the December 31, 1977, $80,000 promissory note to Walker Bank signed by Tebbs and petitioner. Petitioner paid that amount in 1981. Petitioner claims herein a theft loss in 1981 in the amount of $71,000, relating to his payment of that amount in 1981 on the promissory note to Walker Bank.

OPINION

Petitioner alleges that he was induced by fraudulent misrepresentations of Tebbs to endorse and cosign the December 31, 1977, promissory note to Walker Bank totaling $80,000 and that in 1981 when he paid $71,000 to Walker Bank on that note, he incurred a theft loss deductible under section 165(c)(3).[4] Respondent alleges, among other things, that petitioner's payment of the $71,000 did not arise out of a theft and that if anyone was robbed by Tebbs, it was TMT Mutual, not petitioner. For the reasons explained below we agree with respondent.

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[4] Sec. 165 provides in relevant part:

> (a) General Rule.--There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.
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> * * *
>
> (c) Limitation on Losses of Individuals.--In the case of an individual, the deduction under subsection (a) shall be limited to--
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> * * *
>
> (3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. * * *

For Federal income tax purposes, the issue of whether a theft loss occurred must be determined under the laws of the state or other jurisdiction wherein the loss allegedly was sustained. Paine v. Commissioner, 63 T.C. 736, 740 (1975), affd. without published opinion 523 F.2d 1053 (5th Cir. 1975); Monteleone v. Commissioner, 34 T.C. 688, 692 (1960). The exact nature of a theft, whether it be larceny, embezzlement, obtaining money by false pretenses, or other wrongful deprivation of property of another, is of little importance provided it constitutes a theft. Edwards v. Bromberg, 232 F.2d 107, 111 (5th Cir. 1956); Norton v. Commissioner, 40 T.C. 500, 506 (1963), affd. 333 F.2d 1005 (9th Cir. 1964).

Petitioners bear the burden of proof with respect to this issue. Rule 142(a). A criminal conviction is not necessary to prove that a theft occurred; however, the alleged loss must be shown to have been occasioned by circumstances clearly indicating theft. Monteleone v. Commissioner, supra at 694; Vietzke v. Commissioner, 37 T.C. 504, 510 (1961); Jones v. Commissioner, 24 T.C. 525, 528 (1955).

Utah Code Ann. § 76-6-404 (1978) defines theft as follows:

> Theft--Elements.--A person commits theft if he obtains or exercises unauthorized control over the property of another with a purpose to deprive him thereof.

Petitioner contends that he was the victim of "theft by deception." Utah Code Ann. § 76-6-405 (1978) defines theft by deception as follows:

> Theft by deception.--(1) A person commits theft if he obtains or exercises control over property of another by deception and with a purpose to deprive him thereof.
>
> (2) Theft by deception does not occur, however, when there is only falsity as to matters having no pecuniary significance, or puffing by statements unlikely to deceive ordinary persons in the group addressed. "Puffing" means an exaggerated commendation of wares or worth in communications addressed to the public or to a class or group.

Petitioner contends that prior to the time he signed the $80,000 promissory note on December 31, 1977, Tebbs told him that the funds to be obtained by Tebbs and TMT Mutual as a result of the loan were to be used to satisfy TMT Mutual's $50,000 escrow deposit requirement. Because the escrow account actually already had been funded in April of 1977 (with the funds Tebbs alone had borrowed from Walker Bank and apparently reloaned to TMT Mutual), petitioner alleges that he was deceived when Tebbs told him that his co-signature on the December promissory note was necessary for that purpose.

Petitioner also alleges that Tebbs committed securities fraud and embezzlement of corporate funds under Utah law by soliciting investors for an insurance company prior to obtaining the required certificate of solicitation and by misappropriating the $50,000 Tebbs, as president of TMT Mutual, received in March of 1978 when the escrow account at Walker Bank was closed and Tebbs deposited the $50,000 into his wife's personal account. More specifically, petitioner is most upset with Tebbs and describes him as a "common thief" who has traded in his "gun and mask * * * for a 3 piece suit, fancy cars, and a seductive smile * * *" and as a "wolf in sheep's clothing."

We recognize and regard as most unfortunate the losses petitioner realized in connection with his investment in TMT Mutual at Tebbs' behest. We do not dispute that misrepresentations may have been made by Tebbs as an inducement for petitioner to make his initial $8,000 contribution to TMT Mutual. That $8,000, however, is not the loss that is at issue herein. The loss claimed by petitioner as a theft loss in 1981 arises from petitioner's payment in that year of $71,000 to Walker Bank as a result of his obligation as cosigner of the December 30, 1977, promissory note. We must decide whether petitioner's signature as comaker of that note was obtained by theft or by deception.

As explained, the deception that allegedly occurred in December of 1977 is that Tebbs told petitioner that the loan proceeds were needed to fund the escrow account of TMT Mutual before TMT Mutual could receive its certificate of authority from the Utah Insurance Commissioner when in fact both of those events already had occurred in April of 1977. We cannot and do not accept petitioner's version of the alleged deception. We find it simply incredible that by the time petitioner cosigned the

$80,000 promissory note to Walker Bank on December 30, 1977, petitioner would not have realized that TMT Mutual, at that time, already had its Certificate of Authority and already had funded the escrow account required by state law. By that time, petitioner had contributed $8,000 to TMT Mutual, and he had endorsed a $12,000 promissory note to Valley Bank in connection with the business of TMT Mutual.

The $80,000 promissory note that petitioner cosigned, as he surely must have known, did not result in new funds being made available to him, to Tebbs or to TMT Mutual, but was simply a refinancing of prior loans made to Tebbs. No new funds, therefore, became available as a result of his signature on that promissory note to fund anything, let alone the escrow account of TMT Mutual. We cannot accept the implication of petitioner's testimony that he made no effort in December of 1977 to verify with Walker Bank whether the escrow account had been established, whether and, if not, why not, TMT Mutual had received its Certificate of Authority and where the $80,000 loan proceeds went that previously had been obtained by Tebbs for use by TMT Mutual, the refinancing in which petitioner was now participating.

The loan report of Walker Bank, dated January 24, 1978, concerning the December 31, 1977, $80,000 refinancing confirms that the refinancing was discussed personally between petitioner and the bank's loan officer, and petitioner expressly agreed with the loan officer that he (petitioner) would make "four equal annual payments to pay the loan out." This indicates that petitioner was something other than a passive individual who simply was cosigning the note as a personal accommodation for a friend with no anticipation of actually being required to make payments thereunder. We also note that when petitioner filed his claim in Tebbs' bankruptcy proceeding he did not therein contend that Tebbs' obligation to him arose out of a theft or a fraud, but only out of a debtor-creditor relationship.

On the record before us, we conclude that although petitioner may well have been misled by Tebbs with respect to some significant aspects of his investment in TMT Mutual, his cosigning of the December 30, 1977, promissory note (which was only a refinancing and which produced no new funds) constituted a debt undertaking on his part which he intentionally and knowingly agreed to and was not based upon, nor induced by a theft or deception against him.

Petitioner also alleges that investors in Utah (including himself) generally tend to be unsophisticated, naive, and particularly susceptible to being defrauded. Such a contention is beyond the scope of this proceeding and is quite extraneous to the relevant evidence before us. Petitioner was well educated, articulate, intelligent and apparently very successful in his medical practice. We find that he knew what he was doing when he cosigned the $80,000 promissory note. His obligation thereunder that resulted in the payment of $71,000 in 1981 to Walker Bank did not arise from a theft.

Decision will be entered
under Rule 155.

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JU11.7/2:1986-179

ORIGINAL

T. C. Memo. 1986-179

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UNITED STATES TAX COURT

LEO MASTERS AND BARBARA MASTERS, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 29831-82. Filed April 30, 1986.

Leo Masters and Barbara Masters, pro se.

Gloria Gooding, for the respondent.

MEMORANDUM OPINION

DRENNEN, Judge: This case was assigned to Special Trial Judge Helen A. Buckley pursuant to section 7456 of the Code and Rules 180 and 183.[1] The Court agrees with and adopts her opinion which is set forth below.

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[1] Section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated, and all Rule references are to the Court's Rules of Practice and Procedure.

OPINION OF THE SPECIAL TRIAL JUDGE

BUCKLEY, Special Trial Judge: Respondent determined deficiencies in petitioners' Federal income taxes as follows:

			Additions to Tax		
Petitioner	Year	Tax	§6651(a)	§6653(a)	§6654(a)
Leo Masters	1979	$6,149.73	$1,461.18	307.49	242.27
	1980	8,632.56	2,157.89	431.63	552.40
Barbara Masters	1979	1,657.00	200.25	82.85	24.65

Petitioners timely filed their petition for a redetermination to this Court, at which time they resided at Bellflower, California. The petition alleged as follows:

> A. The determination of deficiency set forth in said notice is based on an arbitrary assumption.
>
> B. No consideration or allowance was given for legitimate and proper deductions.
>
> C. Penalties were arbitrarily and erroneously asserted.
>
> D. The Statutory Notice of Deficiency was issued with lack of Due Process.
>
> E. Petitioners' questions on important issues of law and fact, submitted in writing prior to the issuance of this Statutory Notice of Deficiency remain unanswered. Until these unanswered questions of law are resolved by appropriate due process of law, Petitioners would be forced to waive important rights to either prosecute or defend the Commissioner's allegations of deficiency.
>
> F. The inclusion of the wife in the determination of the deficiency based on the alleged income of the spouse goes outside the law and contrary to the equal protection clause of the United States Constitution.

5. The facts upon which Petitioners rely are as follows:

A. That the determination of the gross income and allocation was based on the arbitrary assumption of an agent of the Commissioner of the Internal Revenue, without verification or basis, that it was Petitioners' actual income and upon the erroneous assumption that Petitioners did not file a return.

B. That the Delinquency Penalty, Section 6651(a) is arbitrarily asserted on the erroneous assumption Petitioner did not file a return.

C. That the Negligence Penalty, Section 6653(a) was asserted arbitrarily and without basis.

D. That the Estimated Tax Penalty, Section 6654(a) was asserted arbitrarily and without basis.

E. That no expenses or exemptions were allowed by respondents of known expenses or exemptions.

F. The wife does not have control of the books and records of the spouse needed to prove this deficiency wrong. If they lived in a non-community property state the wife would have immunity from an assessment based on the spouse's wages.

Respondent's determinations were based upon a failure to file returns and to report income from wages as follows:

Leo Masters	1979	$26,507
	1980	32,524
Barbara Masters	1979	12,219

Petitioners' argument, in their trial memoranda and at the hearing herein, is that the compensation they received for their services was income for purposes of social security taxes, but not for purposes of income tax. Petitioners, of course, are completely wrong and we believe that they knew at the time of trial that they were wrong. We addressed this argument, inter alia, in Rowlee v. Commissioner, 80 T.C. 1111 (1983), an opinion admittedly read by petitioners prior to the trial. In Rowlee we held that compensation for services is income for purposes of section 61.

Petitioners bear the burden of proving that respondent's determinations of deficiency are incorrect. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a), Tax Court Rules of Practice and Procedure. Petitioners were advised that they bore this burden and were asked by the Court, "Do you have anything that can show that the amounts of income shown thereon are incorrect, or that you were not allowed deductions, exemptions and credits which you should have been allowed?" Petitioners, however, refused to proceed further.[2] Accordingly, we hold that petitioners are

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[2] Respondent placed into evidence proof of receipt of wages by petitioners as follows:

Barbara Masters - 1979

T. Hart Baker, M.D.	$12,219.42

Barbara Masters - 1980

T. Hart Baker, M.D.	$9,343.09

Leo Masters - 1979

American Bridge Division	$ 194.32
Kaiser Steel Corp.	3,288.64
Chicago Bridge & Iron Co.	166.81
Westeel Constructors, Inc.	4,703.74

(footnote continued)

liable for the tax and additions to tax shown on the statutory notices of deficiency. They failed to file Federal income tax returns for the years in question. They received wages which they failed to report.

We now consider respondent's motion for the imposition of damages pursuant to section 6673. Petitioners were given ample warning that damages would be imposed if they persisted in arguing that the compensation they received for their services did not constitute an item of income within the meaning of section 61. Nevertheless, they persisted in their contentions

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(footnote continued from previous page)

Catalytic, Inc.	3,134.46
Grunau Company, Inc.	890.88
Jesco, Inc.	3,411.73
Cyprus Spec Steel Co.	8,310.24
Western Petro-Chem Service, Inc.	2,990.24

Leo Masters - 1980

Catalytic, Inc.	$6,722.17
Pittsburg-Des Moines Corp.	5,374.56
B & W Construction Co.	4,001.08
Western Petro-Chem	4,199.12
Gatx Tank Erection Corp.	1,634.56
Oil Field Construction Co.	539.00
Oil Field Construction Co.	1,954.09

Barbara Masters' 1980 year is not before the Court and we have not considered this item. The total wages received by Leo Masters as indicated from respondent's exhibits totals $27,091.06 and the statutory notice indicates only $26,507 in unreported income. Respondent did not move to amend his answer and we therefore consider only the amount contained in the statutory notice. In regard to Leo Master's 1980 year, respondent's exhibits total $24,424.58 while the statutory notice indicates $32,524 in unreported income. Petitioners, however, chose not to contest the amounts shown on the notice of deficiency. Since they failed to prove, or even argue, that the statutory notice was incorrect, we hold Leo received $32,524 in unreported income for 1980.

despite being told that the courts had consistently ruled against them. Barbara Masters, in particular, had previously raised the same argument before this Court in regard to her 1981 income taxes. She was told then that compensation for labor did in fact constitute gross income. When she refused to go forward with her case it was dismissed for her failure properly to prosecute and her failure to provide evidence, and damages of $2,000 were awarded to the United States. Masters v. Commissioner, T.C. Memo. 1985-116, on appeal (9th Cir., June 7, 1985). We find that in the case at bar petitioners have maintained a frivolous and groundless position and we find that they have done this primarily for purposes of delay. Accordingly, we award damages to the United States in the amount of $5,000.

We have taken considerable pains in this matter to fully advise petitioners, who are laypersons, of the state of the law. There is a point, however, where it becomes impossible to dissuade petitioners from their folly. This is such a case. We think it advisable to repeat herein the admonition contained in the opinion regarding Barbara Master's 1981 year:

> Indeed, the Court hopes that it is by now apparent to petitioner that those persons advising her as to her course of action before this Court and who assisted her in the preparation of the various frivolous papers she has filed with the Court, could not have been working towards her best interests but, rather, toward their own private agenda.

Decision will be entered

for the respondent.

COMPLETED
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JU 11.7/2:1986-180

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T. C. Memo. 1986-180

UNITED STATES TAX COURT

CHARLES AMABILE AND CARMELA AMABILE, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 1283-84. Filed May 1, 1986.

John F. Papsidero, for the petitioner.

Anne M. DiFonzo, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

PARR, Judge:[*] Respondent determined a deficiency in petitioners' Federal income tax for the taxable years 1979 and 1980 in the amounts of $2,838 and $5,457, respectively. The only issue presented is whether under section 677[1] Charles Amabile should be treated as the owner of 100 per cent and 50 percent, respectively, of two trusts.

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[*] By order of the Chief Judge, this case was reassigned to Judge Parr for decision and opinion.

This case was submitted fully stipulated pursuant to Rule 122. The stipulation of facts and the attached exhibits are incorporated herein. The pertinent facts are summarized below.

FINDINGS OF FACT

Petitioners Charles and Carmela Amabile, husband and wife, resided in North Tonawanda, New York on January 16, 1984, the date the petition was filed in this case. They filed their joint Federal income tax returns for the calendar years 1979 and 1980 with the Internal Revenue Service Center in Andover, Massachusetts.

Carmela's Trust

On July 15, 1973, Charles created an inter vivos irrevocable trust for the benefit of Carmela (Carmela's Trust). Charles' brother, Angelo C. Amabile, was named trustee.

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[1] All statutory references are to the Internal Revenue Code of 1954, as in effect in the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, except as otherwise noted.

Carmela's Trust provides, in pertinent part, as follows:

> Article I: * * * During the lifetime of the grantor, the trustee shall distribute income to the primary beneficiary Carmela C. Amabile in such amount as the trustee, in his sole discretion, shall determine; in the event the grantor predeceases the primary beneficiary, the trustee shall distribute to the primary beneficiary the amount of twenty thousand and no/100 ($20,000.00) dollars as soon as possible, then per year from income and/or principal payable not more frequently than quarterly. Any net income not paid or applied by the trustee during any trust, [sic] accounting year shall be added to the principal of the trust estate. The primary beneficiary may, at any time, or from time to time, request distribution to her from principal and may receive such distributions only with the consent of the trustee which shall not be unreasonably withheld. However, in the event the trustee fails to consent, and the primary beneficiary feels that the failure to consent is unreasonable, then John F. Papsidero is hereby appointed to arbitrate and decide the matter. In the event John F. Papsidero becomes trustee, pursuant to Article VII of this agreement, then the primary beneficiary and the trustee will select an arbitrator.
>
> Article II: The grantor directs the trustee to receive the income and dispose of the income of the trust subject to the provisions contained in this agreement during the lifetime of the primary beneficiary.
>
> Upon the death of such beneficiary, the trustee shall pay or distribute any principal remaining in such beneficiary's trust, as it shall then exist, together with all income then accrued but not then collectible, in such shares or proportions as such beneficiary, by her last will and testament duly admitted to probate shall appoint, or in default of such appointment or to the extent such appointment is ineffective, to and among the issue of such beneficiary then living, per stirpes, or if no issue of such beneficiary shall be living then, to or among the person or persons to whom, and in such as, [sic] the grantor's net distributable estate would be distributable if he had died intestate immediately after the death of such beneficiary and a resident of New York State.

Under Article III, the trustees are given wide latitude to manage the trust, including the authority to purchase and otherwise acquire property and to "make distributions in cash or in kind or partly each." The trustee must submit an accounting to the beneficiary within 90 days following the end of an accounting year, and

> the written approval of any accounting of the trustee by all of the persons of full age and sound mind to whom the trustee is then authorized to distribute the current income from the trust shall bind and be conclusive upon all persons having or claiming any interest under this agreement * * *.

Article IX provides that the trust agreement shall be construed under the laws of the State of New York.

Upon the trust's creation, Charles assigned to it a note payable from H & F Food Products Company, Inc. (H & F) in the amount of $50,000, with interest payable at 7-1/2 percent per annum.

Apparently, Carmela's Trust later received additional assets. A schedule attached to the U.S. Fiduciary Income Tax Return (Form 1041) filed for the fiscal year ending June 30, 1979 reflects interest income of $5,572.82 from certificates of deposit and $1,033.23 from Niagara First Savings and Loan in addition to $3,290.00 from H & F. No further information appears in the record regarding the source of this income.[2] In addition, the trust deducted on the same return $728.44 to insure an asset, the identity of which is unrevealed. Some rental property was obtained by the trust, but not until January 2, 1980, as reflected on a Form 4562 depreciation schedule attached to the Form 1041 filed for the trust's fiscal year ended June 30, 1980. No proof has been offered to suggest how, or with what funds, this property was obtained.[3]

The following income and deductions were reported by Carmela's Trust for the fiscal years at issue:

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[2] We note, however, that the petition alleges Charles transferred to the trust on its formation 50 shares of common stock of the Amabile Brothers Realty Corporation and yearly thereafter an indefinite number of shares of common stock of H & F Food Products Co., Inc. The relationship between these assets and the interest-bearing assets scheduled in the 1979 fiduciary return is not clarified by petitioners' statement on brief that "there is no evidence to show that the petitioner, Charles Amabile, was the grantor of any portion of either trust except the promissory note transferred to [Carmela's] trust * * *." We note further that the trust agreement refers to a schedule "hereunto appended" of all property transferred to the trust by the grantor. That schedule is conspicuously absent from the record.

[3] However the interest income reported on the 1980 fiduciary return was almost double that reported on the 1979 fiduciary return. This makes the lack of proof as to the source of funds for the realty purchase more glaring.

	FYE 6/30/79	FYE 6/30/80
Interest income	$9,896.05[4]	$18,119.00
Rental income	--	--
Depreciation	--	(1,363.00)[5]
Rental expenses	--	(632.00)
Interest expense	--	(4,364.00)
Taxes	(349.65)	(427.00)
Professional fees	(200.00)	(300.00)
Insurance[6]	(728.44)	(787.00)
Distributions	(600.00)	(400.00)
Exemption	(300.00)	(300.00)
	$7,717.96	$9,546.00

In the taxable year ended June 30, 1979 Carmela's Trust distributed $600 to Carmela, which petitioners reported as income on their income tax return for 1979. In the taxable year ended June 30, 1980, Carmela's Trust distributed $400 to Carmela, which petitioners reported as income on their income tax return for 1980.

In the notice of deficiency respondent disregarded Carmela's Trust in full. Respondent attributed the trust's income and deductions for the taxable years ended June 30, 1979 and June 30,

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[4] Respondent rounded off these figures in attributing them to petitioners' income for 1979.

[5] In his notice of deficiency respondent allocated $1,362 as a deduction on petitioners' 1980 income taxes. No explanation for this discrepancy appears in the record.

[6] Respondent did not allow petitioners a deduction for this item. No explanation appears in the record. However, since petitioners have not contested this item, respondent's determination is presumed correct.

1980 to Charles, in calendar years 1979 and 1980. Respondent recalculated petitioners' 1979 and 1980 taxable income accordingly.

The Ramsdell Street Trust

On July 1, 1979 Charles and Angelo created the Ramsdell Street Trust. As will become apparent, the record is weighed and found wanting when it comes to the second trust. Charles and Angelo were both the grantors and the trustees of the Ramsdell Street Trust.[7] According to Article I of the trust document the beneficiaries are:

> 50 percent-- Charles M. Amabile, trustee, under an agreement dated July 15, 1973.
>
> 50 percent-- Angelo C. Amabile, trustee, under an agreement dated July 15, 1973.

On its state fiduciary return for the fiscal year ended June 30, 1980, the Ramsdell Street Trust lists one of the beneficiaries as Carmela Amabile of petitioners' address. We therefore infer that the second agreement referred to in Article I, above, is the instrument creating Carmela's Trust, and that Carmela's Trust is a 50 percent beneficiary of the Ramsdell Street Trust.

The other beneficiary listed on the state fiduciary return is Angela Amabile, of Tucson, Ariz. The record is silent as to the identity of Angela Amabile. However, based on the state fiduciary return which has been stipulated into evidence, we infer that a trust of which she is the beneficiary is itself the beneficiary of the remaining 50 percent of the Ramsdell Street Trust, and that Charles Amabile is trustee of Angela's trust which was created, like Carmela's Trust, on July 15, 1973.

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[7] So stipulated. Moreover, the trust's state fiduciary return for the fiscal year ending June 30, 1980 indicates the grantors are "same as trustees."

The Ramsdell Street Trust is irrevocable. It expires after 15 years "unless sooner terminated at the discretion of the Trustees or upon the direction of a majority of the beneficiaries, at which time this trust shall terminate and the assets contained herein shall be distributed to the beneficiaries."

Article II of the trust provides "The Trustees shall collect the income [from corpus and future additions thereto], which may be paid or applied to the use and benefit of the beneficiaries until the termination of the trust."

The trustees are given wide latitude to manage the trust, including the authority to purchase and otherwise acquire property and "to make distributions in cash or in kind or partly each." They have the power to "do all the things which the Grantors might do if they were managing the Trust Estate as the individual and absolute owner thereof * * *." Again, written approval of an accounting by then-present income beneficiaries "shall bind and be conclusive upon all persons having or claiming any interest under this agreement * * * and shall be a complete discharge to the Trustees * * *." Unlike the case with Carmela's Trust, however, the trustees do not appear to be required by the terms of the trust instrument to submit such an accounting.

The record is unclear as to the corpus of the Ramsdell Street Trust. The trust instrument says only that the trustees "have received certain property and have agreed to have and to hold said property together with any additional property hereafter received by the Trustees * * *." Article II of the trust instrument says "the Trustees shall collect the income therefrom, which may be paid or applied to the use and benefit of the beneficiaries until the termination of the Trust."

The Form 1041 for the taxable year ended June 30, 1980 reports rental income on Schedule A from property listed at "321 Ramsdell Avenue, Industrial."[8] The depreciation schedule (Form 4562) attached to the return indicates a building acquired July 1, 1979 (the date the trust was created), whose cost or other basis is $35,000. Based on the foregoing, we cannot conclusively determine how the real estate was acquired by the trust, whether by contribution or purchase or otherwise. Neither can we determine what, if any additional assets were acquired by the Ramsdell Street Trust, when, how, or from whom.

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[8] The trustees' address listed on Form 1041 is 321 Ramsdell Avenue.

No distributions were made by the Ramsdell Street Trust in the taxable year ended June 30, 1980. The following income and deductions were reported by the trust for that year:

Interest income	$ 241.00
Rents received	7,200.00
Depreciation	(1,400.00)
Rental expenses	(1,640.00)
N.Y. taxes	(112.00)
Exemption	(300.00)
	$ 3,989.00

Respondent disregarded 50 percent of the Ramsdell Street Trust, treating 50 percent of its income and deductions for the taxable year ended June 30, 1980 as those of petitioners in their 1980 tax year.

OPINION

Under the grantor trust provisions of sections 671 through 678, the grantor or another person may be treated for tax purposes as the owner of all or a portion of a trust. Where the grantor is so treated, the trust is disregarded for tax purposes and items of income, deductions, and credits are attributed to the grantor under section 671.

Respondent contends that these provisions are triggered here by section 677(a), which provides in pertinent part as follows:

> (a) **General Rule.** - The grantor shall be treated as the owner of any portion of a trust, * * * whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be--
>
> (1) distributed to the grantor or the grantor's spouse;

> (2) held or accumulated for future distribution to the grantor or the grantor's spouse; * * *

An adverse party is defined in section 672(a) as "any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust."

A nonadverse party means any person who is not an adverse party. Section 672(b).

A beneficial interest includes a right to share in the income or corpus of the trust, either at the present time (such as an income beneficiary) or in the future (such as a remainder beneficiary). Section 1.672(a)-1(a),(b), Income Tax Regs. A trustee does not have a beneficial interest and cannot be an adverse party solely on the strength of the fiduciary relationship and the trustee's right to fees or commissions. Section 1.672(a)-1(a), Income Tax Regs; see also Duffy v. United States, 487 F.2d 282 (6th Cir. 1973), cert. denied 416 U.S. 938 (1974).

Respondent contends that under the above principles Charles should be treated as the owner of 100 percent of Carmela's Trust and 50 percent of the Ramsdell Street Trust. Of course, the normal presumption of correctness applies to respondent's determination, and the burden of proving that determination incorrect rests with petitioners. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a).

We turn now to an examination of the trusts involved herein, in light of the above principles.

Carmela's Trust

Carmela's Trust appears to fall squarely within the provisions of section 677(a). The application of section 677 was expanded by the Tax Reform Act of 1969[9] to provide that the grantor would be treated as owner of any portion of a trust whose income could be distributed to, or accumulated for, the grantor's spouse. Prior to the amendment, section 677 only applied when income could be distributed or held for the benefit of the grantor. Here, Charles is the grantor and Carmela is his spouse. Income is or may be distributed to her, or held for future distribution to her in the trustee Angelo's discretion.

A remaining question, however, is whether, under the terms of the trust, the approval or consent of adverse party is required. Angelo holds no beneficial interest and is thus a nonadverse party under section 672. Carmela clearly does have a beneficial interest and would ordinarily qualify as an adverse party,[10] but for the 1969 amendment. By that amendment, Congress effectively ruled out the possibility of a spouse being treated as an adverse party when a provision in the trust allows for the income to be used for that spouse's benefit. Vercio v. Commissioner, 73 T.C. 1246, 1258 (1980). Section 1.677(a)-1(b)(2), Income Tax Regs., supports this conclusion.[11] Carmela is not an adverse party.

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[9] Pub. L. 91-172, sec. 332, 83 Stat. 599 (1969).

[10] The old assumption that because of family solidarity a wife's interest in income is not adverse to her husband's, is a (footnote continued)

Although contingent beneficiaries of Carmela's Trust may have an adverse interest therein, their consent or approval is not required before distributions are made to Carmela. Income may thus be distributed to Carmela without the approval or consent of any adverse party. Section 677(a) controls.

(footnote continued from previous page)
concept that often counters reality. Each wife stands on her own feet. Laganas v. Commissioner, 281 F.2d 731, 735 (1st Cir. 1960).

[11] Sec. 1.677(a)-1(b)(2), Income Tax Regs., provides in part:

> With respect to property transferred in trust after October 9, 1969, the grantor is treated, under section 677, in any taxable year as the owner (whether or not he is treated as an owner under section 674) of a portion of a trust of which the income for the taxable year or for a period not within the exception described in paragraph (e) of this section is, or in the discretion of the grantor, or his spouse, or a nonadverse party, or any combination thereof (without the approval or consent of any adverse party other than the grantor's spouse) may be:
>
> (i) Distributed to the grantor or the grantor's spouse;
>
> (ii) Held or accumulated for future distribution to the grantor or the grantor's spouse * * * [Emphasis added.]

The thrust of petitioners' argument deals with the identity of the grantor. On brief, they contend "[i]t cannot be assumed by the Court that since Charles Amabile is called a grantor by the trust language he is also a contributor of any asset other than the promissory note." They state that interest payable at 7-1/2 percent on the $50,000 H & F note would yield no more than $3,750 per year. They seem to suggest that this should limit Charles' tax liability as grantor of Carmela's Trust. In their two page reply brief petitioners add:

> Respondent's position is based upon the arbitrary assumption that Charles Amabile did in fact transfer property to the trust for the benefit of Carmela Amabile, and did in fact transfer property to the Ramsdell Street Trust.
>
> The respondent does not request any finding of fact showing the transfer of property into the respective trusts by Charles Amabile.

Petitioners misconstrue the law. The adjustments shown in the notice of deficiency are based upon amounts of income and deductions reported by the trust in its Fiduciary Income Tax Returns for 1978 and 1979. Respondent's notice of deficiency is, therefore, clearly not arbitrary. Respondent's statutory notice is presumed to be correct. The burden to prove otherwise is on petitioners. Welch v. Helvering, 290 U.S. 111 (1933); Rules 142(a), 122(b).

There may be times when someone other than the actual creator of a trust is its grantor. See Bixby v. Commissioner, 58 T.C. 757 (1972). If petitioners had introduced competent evidence that someone other than Charles funded the trust, this argument would be relevant. However, petitioners' argument fails for lack of proof. We, therefore, agree with respondent and hold that under the provisions of section 677(a) Charles should be taxed as the owner of Carmela's Trust. Respondent's determination as to Carmela's Trust is sustained.

The Ramsdell Street Trust

We also conclude that petitioners have not carried their burden with respect to the second trust. Despite their requested finding that Charles did not transfer property into the trust, petitioners offered no competent proof of how the trust acquired its income-producing real property. Carmela's Trust (and, hence, Carmela) could receive distributions from the Ramsdell Street Trust without the assent of any adverse party. Therefore, under the rationale discussed above, we sustain respondent's determination that Charles is the 50 percent owner of the Ramsdell Street Trust. Welch v. Helvering, 290 U.S. 111 (1933), Rules 142(a), 122(b).

In any event, simple logic demands the same result. We have already concluded Charles must be treated as the owner of Carmela's Trust. Carmela's Trust owns 50 percent of the Ramsdell Street Trust. Therefore, Charles must be treated as the owner of 50 percent of the Ramsdell Street Trust.

Years of Inclusion

With regard to both trusts, petitioners contend that even if respondent is correct on the merits, the entire annual trust income cannot be attributed to them in the calendar year within which the trust's fiscal year ends. They assert income should pass through to them in the calendar year it was actually earned. Petitioners are correct. See Scheft v. Commissioner, 59 T.C. 428 (1972). Although we have here a fractional trust interest which we did not have in Scheft, the complexities posed by such a situation are not so great as to compel a contrary result on this issue. See Scheft v. Commissioner, supra at 435.

To reflect the foregoing,

Decision will be
entered under Rule 155.

COMPLETED

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Ju 11.7/2: 1986-181

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T. C. Memo. 1986-181

UNITED STATES TAX COURT

PAUL A. PURSER AND KATHLEEN PURSER, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 22774-81. Filed May 1, 1986.

Perry O. Lemmons, for the petitioners.

Bonnie L. Cameron, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

CLAPP, Judge: Respondent determined deficiencies in petitioners' Federal income tax and additions to tax under section 6653(b)[1] as follows:

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

Year	Deficiency	Additions to Tax Sec. 6653(b)
1973	$30,181.08	$15,090.54
1974	39,507.98	19,753.99

This Court has already held that petitioners are liable for the additions to tax imposed by section 6653(b) on any deficiencies finally determined for the years at issue.[2] After concessions by the parties, the only issues remaining are whether petitioners received additional unreported income of $23,314.80 and were entitled to a $3,000 business expense deduction, both from Paul Purser's carpet installation business and both for the year 1974.

FINDINGS OF FACT

The stipulation of facts and the exhibits attached thereto are incorporated herein by this reference. Petitioners resided at Kennesaw, Georgia at the time they filed their petition.

Petitioner, Paul A. Purser (Paul or petitioner), has been in the carpet installation business since 1969. He operated as a sole proprietorship until at least December 1973 when he formed Purser Enterprises, Inc., a Georgia corporation. However, petitioner continued to report the income and expenses of his carpet installation business on his joint individual tax returns. He never filed a Federal corporate income tax return, nor did the corporation issue stock, hold corporate meetings, or file annual reports to the state. Both parties have ignored the corporation and have continued to treat petitioner's business as a sole proprietorship through the year 1974. We will do likewise.

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[2] Purser v. Commissioner, T.C. Memo. 1983-573.

Substantially all of petitioner's carpet installation work during the years at issue originated with Asia Rug Company (Asia Rug) a sole proprietorship, which was owned and managed by petitioner's father William H. Purser (William). Asia Rug contracted for the sale and installation of carpet. Paul did the majority of the installation, particularly in the Metro Atlanta area. Asia Rug paid petitioner for his installation services either by its checks payable to him or by endorsement to him of checks payable to Asia Rug. These payments were net after any expenses such as payroll, supplies, or materials incurred by petitioner but paid by Asia Rug. Petitioner maintained no carpet inventory. His expenses of doing business were paid by Asia Rug. Petitioner had a small crew of men who helped him install carpets during the years at issue, but these men were paid by Asia Rug and all payroll accounting, including income tax and social security withholding and preparation of Forms W-2, was done by Asia Rug.

Petitioner did not maintain formal books and records for his business operations as a carpet installer, but relied upon cancelled checks and check stubs to prepare his income tax returns. Asia Rug (William) maintained job order books to reflect the normal day-to-day operations of the business. The books were in William's handwriting. These books contained information regarding the location of a job, the customer, the charges for the carpet, the sales tax, and the cost of installation. The books contained periodic summaries of business activity. Although informal and not very sophisticated, these books provided a reasonably accurate basis from which Asia Rug could determine the amounts due from customers and the amounts of its expenses including the amounts due to petitioner for installation work. The business books and records of Asia Rug leave quite a bit to be desired, but they were superior to the almost nonexistent records of petitioner.

Respondent's agents, during the course of the tax audit, attempted to reconstruct from the records of Asia Rug and from bank records available to them the proper amount of petitioner's income for the years 1973 and 1974. The results served as a basis for the deficiencies determined by respondent. The parties have agreed on all deficiencies for the year 1973 and on all items but $23,314.80 of allegedly understated income and $3,000.00 of allegedly overstated expenses for the year 1974.

OPINION

Respondent's determinations of deficiencies in income tax are presumed to be correct and the burden of proof to overcome that presumption and to establish the correct amounts is upon petitioner. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a).[3]

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[3] All references to Rules are to the Tax Court Rules of Practice and Procedure.

The additional understatement of income in the amount of $23,314.80 as determined by respondent, was derived from business records maintained by William, which William believed to be very accurate and which we have found not to be inaccurate, but only rather informal and unsophisticated. From these records, the total amounts due petitioner for the years 1973 and 1974 were aggregated. Respondent then subtracted the amounts paid to petitioner by Asia Rug either by its checks or by endorsement of customer's checks (which total amount was the same as the amount shown on the Form 1099 provided by Asia Rug to petitioner) and the difference was $23,314.80. Petitioner originally reported less than the amount shown on the Form 1099, but has since conceded that the total amount of the Form 1099 should have been included in his income. Respondent also determined that there was unreported income from customers of petitioner other than Asia Rug and petitioner has conceded those amounts in full so they are no longer in issue. We are concerned only with the $23,314.80 by which the amounts due to petitioner exceed the amounts paid to petitioner as shown by the records of Asia Rug.

Respondent's agent found two deposits in the total amount of $25,000 made to petitioner's bank accounts in early 1974 which were above and beyond the amounts shown by Asia Rug's records to have been paid to petitioner. Respondent concluded that this $25,000, which petitioner concedes came from William and/or Asia Rug, was a payment of the excess due to petitioner and accordingly, determined the $23,314.80 of additional income.

Petitioner argues with respect to the $23,314.80 of additional income that the $25,000 constituted a loan made to petitioner by William for the purpose of assisting him in the purchase of a home which loan was later forgiven thus constituting a gift to petitioner. In either event, whether this was a loan or a gift, petitioner argues that it was not income. The evidence supporting the loan-gift theory is something less than conclusive and is muddied by the statements made by petitioner to the revenue agent in the course of the audit that the $25,000 was cash that he had accumulated in a shoe box over the prior half-dozen years or so, which he used to help buy his house. Petitioner conceded that he had made the earlier statements, but alleges that they were made out of fear and confusion with respect to tax consequences and in his testimony at the trial stated that the loan-gift theory was what actually happened.

Due to the inadequacy of petitioner's records and the informality of Asia Rug's records, it is difficult to reconstruct exactly what happened here. Respondent's agents have devoted considerable time to the reconciliation of the records available with bank deposits and the ultimate reconstruction of petitioner's income for the years at issue. Petitioner's loan-gift theory with respect to the $25,000 is rather shaky, particularly in view of the fact that no evidence was introduced to show that the $23,314.80 which was admittedly due to petitioner was in fact paid by Asia Rug at any other time or in any other form. Petitioner has not carried his burden of proving that respondent's determination was erroneous.

With respect to the additional $3,000 of expenses claimed by petitioner, we also find for respondent. Petitioner has produced no check or other evidence that the $3,000 was paid. The only evidence on this subject produced by petitioner was an invoice showing the amount to be due, which is clearly different in form from all of the other invoices in the record. This raises substantial questions as to the authenticity of that invoice and we find that it falls far short of establishing the $3,000 expense claimed by petitioner. Again, petitioner has failed to meet his burden of proof.

Decision will be entered
under Rule 155.

COMPLETED

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Ju 11.7/2: 1986-182

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T. C. Memo. 1986-182

UNITED STATES TAX COURT

CHARLEAN DICKSON AND WILLIE R. DICKSON, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 25171-82. Filed May 5, 1986.

Charlean Dickson and Willie R. Dickson, pro se.

Erin Collins, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GERBER, Judge: Respondent, for the taxable years 1978 and 1979, determined deficiencies in Federal income tax in the amounts of $7,918.61 and $7,234.90 and additions to tax under section 6651(a)[1] in the amounts of $1,155.33 and $273.34, respectively. By his amendment to answer, filed May 16, 1985, respondent sought an increased deficiency for the taxable year 1979 in the amount of $808.10 which would increase the amount determined in the statutory notice for the taxable year 1979 to $8,043. The parties have agreed to several of the issues raised by the statutory notice, leaving the following issues for the Court's consideration: (1) Whether petitioners' basis for depreciation of rental property should be the fair market value or the adjusted basis and, if adjusted basis, whether petitioners can substantiate an adjusted basis in excess of that allowed by respondent; (2) whether petitioners' writing and promotional activity conducted as "Dickson's Innovative Enterprises" constituted an activity for profit and, accordingly, whether petitioners' claimed loss is deductible for the taxable year 1979; (3) whether petitioners are entitled to deduct the expenditures of maintaining an office in their home during the taxable year 1979; and (4) whether, as part of a casualty loss, petitioners are entitled to claim the amount expended to rent an automobile in order to provide transportation to and from the place of petitioner's employment.

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue. All rule references are to the Tax Court Rules of Practice and Procedure.

Some of the facts have been stipulated, and the stipulation of facts and exhibits thereto are incorporated herein by this reference. Petitioners, Willie R. and Charlean Dickson, are husband and wife and they resided in Upland, California, at the time of filing their petition herein. Petitioners' 1978 and 1979 joint Federal income tax returns were filed with the Fresno, California, Internal Revenue Service Center on May 5, 1980.

Although the parties settled several issues by means of their stipulation of facts, neither party, either on brief or otherwise, referenced the addition to tax under section 6651(a) which concerns the determination that petitioners filed their joint income tax returns late. It is clear from the record that both returns were filed beyond the April 15 deadline and petitioners have offered no evidence to explain the late filing. Accordingly, we find that respondent correctly determined additions to tax pursuant to section 6651(a)(1) for the taxable years 1978 and 1979. *Welch v. Helvering*, 290 U.S. 111 (1933); Rule 142(a).

Casualty Loss, Deduction of Rental Car

The parties have agreed that petitioners incurred a casualty loss in the amount of $300 during 1979 attributable to damage to petitioners' automobile. In addition, petitioners incurred $300 for the rental of an automobile to provide Mrs. Dickson with transportation to and from her place of employment. Section 165(c)(3) permits individuals to deduct losses of property from a casualty. Petitioners have claimed a $300 automobile rental expense as part of their casualty (automobile accident). The cost of renting an automobile while a damaged automobile is being repaired is not a loss of property within the meaning of section 165(c)(3). *Feistman v. Commissioner*, T.C. Memo. 1971-137; *Bartlett v. United States*, 397 F. Supp. 216 (D. Md. 1975); see also Rev. Rul. 59-398, 1959-2 C.B. 76.

Petitioners also claim that the cost of a rental automobile would be deductible as connected with petitioners' business. Petitioners' argument is based upon the fact that the rental automobile was only used for Mrs. Dickson's transportation to and from her place of employment. It is well established that transportation between one's residence and place of employment is a personal commuting expense and is not deductible. Commissioner v. Flowers, 326 U.S. 465, 470-474 (1946). In view of the foregoing, we find that no portion of the $300 expended by petitioners for a rental automobile during the taxable year 1979 is deductible as either a casualty loss or a business expense.

Adjusted Basis of Rental Property

During 1964, petitioners purchased a residence on San Carlos Drive, Pomona, California, and resided there until 1977. In 1977, petitioners purchased a second residence and converted the San Carlos Drive residence into rental property (San Carlos property). Petitioners originally purchased the San Carlos property for $14,300, $2,000 of which was attributable to the cost of the land. For purposes of depreciation, petitioners utilized what they thought to be the fair market value, or $51,000, at the time of conversion (1977) of the residential property to rental property. Petitioners purchased $3,200 in carpeting and drapes during 1977 and claimed depreciation in the amount of $523.64 for 1978 and $465.45 for 1979. Respondent, in the statutory notice of deficiency, disallowed all depreciation with respect to the rental property, with the exception of the depreciation claimed for the carpeting and drapes for the 1978 taxable year. By amended answer, respondent similarly disallowed the depreciation attributable to the rental property and allowed the depreciation attributable to the carpeting and drapes for the taxable year 1979.

Petitioners, after reading Internal Revenue Service publications, thought that their conversion of the residence to rental property was an event similar to the receipt of property from a decedent which would provide for a "stepped-up basis" of fair market value. Section 167(g) provides that the basis for depreciation shall be the adjusted basis provided for in section 1011. Section 1011, in conjunction with section 1012, provides that the basis of the property shall be cost, as adjusted under section 1016 for appropriate increases or decreases to the original cost. Petitioners were not able to provide specific documentation as to the capital additions to the San Carlos property. Their testimony, however, was concise and credible. Petitioners remembered specific dates and amounts of improvements to the San Carlos property, all of which seemed reasonable. Based upon the record, we find the following capital improvements were made to the San Carlos property: 1972--conversion of garage into a living room, $4,000; and installation of a sprinkler system, $500. 1976--installation of a new roof, fence and paneling, $1,500. During 1979, petitioners purchased and installed a garbage disposal at a cost of $80. Cohan v.

Commissioner, 39 F.2d 540 (2d Cir. 1930). Respondent did not question the method of depreciation nor the rate employed by petitioners for either of the taxable years in question and, accordingly, those aspects of the depreciation are not in dispute.

In view of the foregoing, we find that the San Carlos property had a depreciable cost basis of $12,300 (exclusive of the land) and that the adjusted basis for purposes of depreciation includes the amounts determined as capital expenditures above.

"Dickson's Innovative Enterprises" - Deductibility of Claimed Expenses - Profit Motive

For the taxable year 1979, respondent has disallowed $465 in claimed expenses by petitioners concerning Mr. Dickson's writing and mail-order activity under the designation "Dickson's Innovative Enterprises." The $465 disallowed was composed of $50 in claimed depreciation attributable to furniture and business machines, $210 of office supplies and postage, $36 in business taxes and $169 for rough draft typing assistance from a free-lance typist. During 1979, Mr. Dickson was employed by Aerojet Electrosystems Co. of Azusa, California. During Mr. Dickson's college education, he had written a thesis concerning career planning. Subsequent to his college education, during the taxable year 1979, Mr. Dickson decided to utilize his writing ability to develop and market literary works on career planning, "how to get a job" and "over 101 ways to improve your bowling."

It was Mr. Dickson's intention to develop and market written materials through a mail-order approach. During the 1979 taxable year, petitioner applied for a post office box, a third-class mailing permit, obtained a business license from the City of Upland, California, at a cost of $36 per annum, designed and purchased business stationery with his logo "Dickson's Innovative Enterprises," purchased office furniture and equipment, test-marketed some of his bowling aid materials, prepared and submitted for rough draft typing written materials concerning the various "how to" subject matters, and contacted printing and publishing houses concerning the cost and method of publication.

During the year 1979, petitioners realized no income from Mr. Dickson's writing and mail-order activity. Respondent argues that petitioner merely had a "subjective * * * intention to make a profit" and that was not sufficient. The standard by which we must determine whether petitioners' claimed deductions are allowable is whether Mr. Dickson's activities were entered into with "the actual and honest objective of making a profit," Dreicer v. Commissioner, 78 T.C. 642, 645 (1982), affd. without opinion 702 F.2d 1205 (D.C. Cir. 1983). Section 1.183-2(a) and (b), Income Tax Regs., defines "activity not engaged in for profit" and lists nine factors to be taken into consideration concerning profit objective. The case law and the regulations make it clear that the standard is subjective. A reasonable expectation of profit is not required.

Respondent argues that Mr. Dickson's activities were only part-time; that his writings were not yet complete; and that Mr. Dickson had a full-time job, was president of the Lions Club and exchange chairman for Youths, so that his writing activities had to take a "back seat" to his other activities. We disagree with respondent's interpretation of the facts in this case. Mr. Dickson spent substantial time in attempting to develop materials and market them with an "actual and honest objective to make a profit." Mr. Dickson's maintaining a full-time job, serving as president of a community and social organization and being involved with young people, in addition to his profit-seeking activities is a positive factor reflecting his motivation, rather than respondent's attempt at negative inference from the fact that petitioner devoted time to other activities. Samples of Mr. Dickson's writing accomplishments and other indicia of his business activity are contained in the record. In the context of this case, petitioners have not incurred substantial losses over a long period of time, see Hires v. Commissioner, T.C. Memo. 1980-172, nor have they derived personal pleasure or recreation from the writing activity or expenditure of funds to purchase business paraphernalia. In view of the foregoing, we find that petitioners were involved in an activity for profit during the taxable year 1979 and the $465 claimed loss is allowable.[2]

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[2] The parties did not raise the issue of whether petitioners' expenditures were subject to the provisions of sec. 280. Therefore, we need not address this issue. See Garrison v. Commissioner, 86 T.C. ___ (Apr. 22, 1986).

Office in the Home

The provisions of section 280A may cause the denial of a deduction to a taxpayer concerning the use of part of their home to engage in business activity. Section 280A basically denies deductions for the use of a private dwelling, which is otherwise used as a residence, with certain exceptions. Under subsection 280A(c)(1), deductions for use of part of a residence are allowable where it is used exclusively on a regular basis as the principal place of business for any trade or business of the taxpayer. The amount deductible is limited to the amount of income derived from the particular business activity conducted in the private residence after reduction for other expenses. Gestrich v. Commissioner, 74 T.C. 525, 530 (1980), affd. without published opinion 681 F.2d 805 (3d Cir. 1982); sec. 280A(c)(5). Because Mr. Dickson did not report any gross income with respect to his writing activity, the limitation of section 280A(c)(5) would serve to obviate the need to consider whether petitioners are otherwise entitled to a deduction for the use of their personal residence for business activity during the taxable year 1979. In view of the foregoing, we hold that petitioners are not entitled to any deductions claimed for 1979 attributable to the use of their personal residence.

To reflect the foregoing and concessions made by the parties,

Decision will be entered under Rule 155.

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T. C. Memo. 1986-183

UNITED STATES TAX COURT

ROBERT P. AND MARY K. WRIGHT, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 9538-84. Filed May 5, 1986.

John A. Holtman, for the petitioners.

Dale P. Kensinger, for the respondent.

MEMORANDUM OPINION

WILLIAMS, Judge*: The Commissioner determined a deficiency in petitioners' Federal income taxes for the taxable year 1980 of $5,118.00 and an addition to tax pursuant to section 6653(a)[1] of $255.90. The issues presented to this Court for decision are (1) whether petitioners' taxable year 1980 was a closed year, and if so, whether respondent improperly reopened the examination of taxable year 1980; and (2) whether respondent is estopped from determining a deficiency in petitioners' Federal income taxes for the taxable year 1980.

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* By order of the Chief Judge, this case was reassigned to Judge Williams for decision and opinion.

The facts of this case have been fully stipulated pursuant to Rule 122, Tax Court Rules of Practice and Procedure, and are so found. Petitioners resided in Overland Park, Kansas at the time their petition was filed.

Respondent conducted an audit of petitioners' federal income tax return for the taxable year 1979 which was expanded to include the taxable year 1980. In connection with this audit, respondent's examining agent issued to petitioners a Form 1902-B, Report of Income Tax Examination Changes, on March 23, 1982. The report proposed a deficiency in federal income tax of $4,350.02 and an addition to tax pursuant to section 6653(a) of $217.50 for the taxable year 1980.

The Form 1902-B received by petitioners stated as follows:

> Although this report is subject to review, you may consider it as your notice that your case is closed if you are not notified of an exception to these findings within 45 days after a signed

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years at issue, unless otherwise indicated.

> copy of this report or a signed waiver, Form 870, is received by the district director. If you agree, please sign one copy of this report, and return it in the enclosed envelope. Keep the other copy with your records.
>
> ---
>
> Consent to Assessment and Collection - I do not wish to exercise my appeal rights with the Internal Revenue Service or to contest in the United States Tax Court the findings in this report. Therefore, I consent to either:
>
> (1) The immediate assessment and collection of the balance due shown on line M, plus any interest due on this tax, and also any penalties shown on line O, or
>
> (2) The overpayment shown on line N, plus any interest and adjusted by penalties shown on line O.

Petitioners signed the form and returned it with a remittance of $5,129.09 representing the total indicated to be due for the taxable year 1980 consisting of the deficiency of $4,350.02, the addition to tax of $217.50 and interest of $561.57. Petitioners read and relied upon the statements in Form 1902-B quoted above in deciding to forego an administrative appeal and to waive their right to petition this Court.

After receiving the executed report together with the remittance, the examining agent forwarded the file relating to petitioners' income tax liability for the taxable year 1980 to the Review Staff, Wichita, Kansas. The Review Staff concluded that the file with respect to petitioners' income tax liability for the taxable year 1980 should be returned for further development.

Examining agent Nancy Atchley telephoned petitioners' representative, Richard O'Connor, within the 45-day period referred to in Form 1902-B. In her memorandum of the call, dated May 6, 1982, the examining agent stated she " * * * explained that the case was being reviewed and that the [Form 1902-B] could not be considered final. POA [power of attorney] wanted to know what the problem was and I said we would let him know." Respondent did not obtain any documents or information from the books and records of petitioners subsequent to May 6, 1982.

On June 9, 1982 the revenue agent to whom petitioners' case had been assigned, Shirley Polzin, telephoned O'Connor and explained that respondent was examining deductions taken by petitioners in taxable year 1980 for employee business expenses. O'Connor informed Polzin that in his view the 45-day period referred to in Form 1902-B had expired, and that therefore the taxable year 1980 was closed.

On March 9, 1983 Polzin telephoned O'Connor to request an appointment to discuss certain items on petitioners' 1980 Federal income tax returns. O'Connor reiterated his view that the taxable year 1980 was a closed year, and on this basis no appointment was scheduled.

On May 5, 1983 respondent issued to petitioners a copy of Form 4549-A, Income Tax Examination Changes, accompanied by an explanation of adjustments. The report proposed a deficiency of

$9,468.00 in petitioners' 1980 Federal income taxes and an addition to tax of $473.40. Included in these amounts were the prior deficiency and addition to tax agreed upon and paid by petitioners pursuant to their execution of Form 1902-B. Form 4549-A gave petitioners the right to an administrative appeal on all proposed adjustments.

On May 12, 1983 petitioners objected to the issuance of Form 4549-A in a letter to respondent, claiming that respondent was attempting to reopen the taxable year 1980 without timely written notice. On May 23, 1983 respondent wrote to petitioners (1) stating that respondent's agent had notified petitioners' representative by telephone on May 6, 1982 that the case was being reviewed and could not be considered final and (2) asking petitioners to complete their protest of the proposed adjustments by stating specifically their objections.[2] On May 30, 1983, petitioners received a Statement of Adjustment to Your Account which indicated a credit against the proposed deficiency of $5,129.09 which represented the amount that petitioners had paid with Form 1902-B.

On January 17, 1984 respondent issued to petitioners the notice of deficiency which is at issue in this case. The amounts of the deficiency and addition to tax represent the difference between the respective figures indicated in the Form

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[2] Respondent's letter incorrectly identified the agent who made the telephone call to Mr. O'Connor.

1902-B executed March 23, 1982 and the Form 4549-A issued to petitioners on May 5, 1983. Petitioners concede the correctness of the deficiency and addition to tax if we determine that respondent was not foreclosed from issuing the notice of deficiency.

Respondent never issued a reopening letter to petitioners.[3] Further, petitioners and respondent never executed a Form 866, Agreement as to Final Determination of Tax Liability.

Petitioners contend that the taxable year 1980 was closed as a result of their execution of Form 1902-B, that respondent improperly reopened a closed taxable year, and that respondent is estopped from determining a deficiency for the closed taxable year. Respondent argues that its notice to petitioners' representative that the Form 1902-B agreement could not be considered final constituted notice within the terms of Form 1902-B that the taxable year was not closed. In the alternative, respondent contends that if the taxable year 1980 was closed, he did not reopen the taxable year.

In this case petitioners properly executed a Form 1902-B the language of which states that petitioners' taxable year 1980 would be closed unless an exception to the report's findings was provided to petitioners within 45 days following the receipt of the executed form. Respondent did not notify petitioners of an exception to the report's findings within the 45-day period. Instead, respondent notified petitioners by telephone only that the report was being reviewed and should not be considered final. This notice provided petitioners with no more information than the agreement itself, which stated that "this report is subject to review." Because respondent did not provide petitioners with an exception to the report as required by Form 1902-B, petitioners' taxable year 1980 was closed.

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[3] For purposes of this case, a reopening letter is one which is issued under the circumstances identified in Rev. Proc. 81-35, 1981-2 C.B. 588.

Respondent may reopen a closed year for additional examination under the circumstances described in Rev. Proc. 81-35, 1981-2 C.B. 588.[4] Although respondent did not follow Rev. Proc. 81-35 in this case, that fact does not resolve the issues before this Court because a reopening is not a condition precedent to the issuance of a notice of deficiency. Further, a notice to the taxpayer is only mandated if an additional inspection of a taxpayer's books and records occurs subsequent to the closing. Section 7605(b). No new inspection of petitioners' books and records took place.[5] See Grossman v. Commissioner, 74 T.C. 1147 (1980). In the absence of a closing agreement or an informal agreement that would estop respondent, there is no proscription against respondent's determination of a deficiency for a closed year. Botany Worsted Mills v. United States, 278 U.S. 282, 288-289 (1929); Rose v. Commissioner, 70 T.C. 558, 561 (1978); Hudock v. Commissioner, 65 T.C. 351, 362 (1975); United States Holding Company v. Commissioner, 44 T.C. 323, 327 (1965). The parties agree that the Form 1902-B executed by petitioners does not constitute a formal closing agreement pursuant to section 7121. For the reasons discussed below, we find that respondent is not estopped from determining the deficiency in petitioners' 1980 income tax.

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[4] These circumstances are described as follows:

> 1. There is evidence of fraud, malfeasance, collusion, concealment or misrepresentation of material fact; or
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> 2. The prior closing involved a clearly defined substantial error based on an established Service position existing at the time of the previous examination; or
>
> 3. Other circumstances exist that indicate failure to reopen would be a serious administrative omission.

Because tax liability should be based upon the law and not on the statements of a government officer or agent, the court will not lightly conclude that respondent is estopped from determining a deficiency. Boulez v. Commissioner, 76 T.C. 209,

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[5] The notice of deficiency issued to petitioners was not derived from a second inspection of petitioners' books and records, and the parties agree that respondent did not obtain any information from the books and records of petitioners subsequent to May 6, 1982. In any event there is no indication in the legislative history that section 7605(b) was intended to restrict the scope of respondent's legitimate power to protect the revenue. See Grossman v. Commissioner, 74 T.C. 1147, 1155 (1980).

215 (1981); Couzens v. Commissioner, 11 B.T.A. 1040, 1148 (1928). Nevertheless, if the elements of an estoppel are proven, justice requires the government to abide by its agreement. Lignos v. United States, 439 F.2d 1364, 1368 (2d Cir. 1971).

In this case the parties agree that in executing the Form 1902-B petitioners read and relied upon the statements therein; namely, that in agreeing to the immediate assessment and collection of the deficiency, addition to tax and interest their case would be closed. Further, respondent's original determination of deficiency was based on the factual error of the nature of certain expenses deducted by petitioners. In relying on the agreement petitioners paid the deficiency and addition to tax without knowing that respondent would take exception to the examining agent's report as stated on Form 1902-B. We cannot, however, conclude that petitioners suffered substantial detriment from relying on respondent's promise to close taxable year 1980.

The detriment suffered by petitioners was that they lost an opportunity for an administrative appeal and an opportunity to have this Court judicially resolve their dispute with respondent at the time they executed Form 1902-B. This detriment falls short of the mark necessary to work an estoppel against the government. First, no actual harm was suffered by petitioners; they agree that respondent's determination is correct. Second, had petitioners wanted to contest the merits of respondent's initial determination at the time they executed Form 1902-B, they could have sought a refund. Third, petitioners could have taken an administrative appeal of the proposed deficiency resulting from the examination, which included the amount previously paid by petitioners, and they could have contested the initial determination in this Court as part of their case involving the deficiency for the same year; petitioners declined to do so. Finally, petitioners have provided no other evidence of the value of any rights they relinquished in executing Form 1902-B. See Davis v. Commissioner, 29 T.C. 878, 896 (1958). On this basis we find that petitioners did not suffer detriment sufficient to support an estoppel against the government. Accordingly, respondent was not estopped from issuing his notice of deficiency to petitioners in January of 1984.

To reflect the foregoing,

Decision will be
entered for the respondent.

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T. C. Memo. 1986-184

UNITED STATES TAX COURT

RICHARD WAYNE FERNLEAF, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 21872-84. Filed May 5, 1986.

Janine L. Hook, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

FAY, Judge: Respondent determined a deficiency with respect to petitioner's 1980 Federal income tax of $10,645.55 and an addition to tax under section 6653(b) of $5,322.78. The issues are (1) whether respondent's motion to dismiss for failure to properly prosecute should be granted; (2) whether petitioner is liable for an addition to tax for fraud under section 6653(b)[1] or alternatively, whether petitioner is liable for an addition to tax for negligence under section 6653(a).

FINDINGS OF FACT

Petitioner, Richard Wayne Fernleaf, resided in Dundee, Ore. when he filed the petition herein.

During the year in issue, petitioner was employed by Publishers' Paper Company of Oregon City, Ore., and Local #60 AWPPW of Newberg, Ore. Petitioner received wages, tips and other compensation in the amount of $35,652.86 and $1,188.43 from the respective employers. On four occasions, during the period from November 26, 1979 to December 29, 1980, petitioner submitted to the payroll department of Publishers' Paper Company Forms W-4 (Employee's Withholding Allowance Certificates). On the first Form W-4, which petitioner submitted on November 26, 1979, he claimed fifty-one withholding allowances. On the second Form W-4, submitted on July 7, 1980, petitioner claimed that he was exempt from withholding because (1) he did not owe Federal income tax in the previous year; (2) he did not expect to owe any Federal income tax in that year; and (3) he expected to have a right to a full refund of all income tax withheld. Thereafter,

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Publishers' Paper Company was advised by respondent that such Form W-4 should no longer be honored and petitioner was notified thereof. Subsequently, petitioner signed and submitted the third Form W-4 on November 18, 1980, whereon he claimed ten withholding allowances. On December 29, 1980, petitioner signed and submitted the fourth Form W-4 whereon he once again claimed to be exempt from withholding. On each of the above-mentioned Forms W-4, petitioner certified under penalty of perjury either that he was entitled to the number of withholding allowances claimed on such Form W-4 or that he was entitled to the exempt status claimed.

Petitioner had filed joint Federal income tax returns with Lula M. Fernleaf for 1978 and 1979, both of which showed properly computed Federal income tax liability. Contrary to his certification of exempt status on two of the Forms W-4 submitted and his statement that he owed no tax in 1979, petitioner's Federal income tax return for 1979 reveals a Federal income tax liability of $1,934.

For 1980, petitioner filed a Form 1040 whereon he indicated his filing status as single. On such Form 1040, he reported $36,841 in wages, salaries and tips, and $54 in interest income, thereby showing a total income amount of $36,895. Petitioner then revised such Form 1040 to claim a deduction for an item entitled "Non-taxable receipts (Eisner v. Macomber, 252 U.S. 189)" in the same amount as his wages, or $36,841, and thus reported his adjusted gross income as $54. Petitioner also claimed and subsequently received a refund for Federal income tax and FICA tax withheld for 1980.

On April 3, 1984, respondent issued a notice of deficiency with respect to petitioner's 1980 Federal income tax whereon respondent disallowed the "non taxable receipts" deduction claimed by petitioner on the Form 1040 filed for that year and further determined that all or part of the underpayment was due to fraud.

Petitioner timely filed a petition with this Court on June 29, 1984, and designated Portland, Ore. as the place of trial. Respondent timely filed his answer to the petition on August 20, 1984 wherein he raised as an alternative to the determination of fraud under section 6653(b) the argument that a portion of the underpayment was due to negligence within the meaning of section 6653(a).

The instant case was set for trial at the Court's trial session beginning on November 26, 1985 at Portland, Ore. A notice setting case for trial from the Clerk of the Court was served on petitioner on August 29, 1985. In such notice petitioner was informed that his failure to appear at trial might result in dismissal of the case and entry of decision against him. Prior to trial, respondent's counsel on August 29, 1985, served upon petitioner interrogatories and a request for production of documents to which petitioner failed to respond. On October 15, 1985, respondent's counsel filed a motion for an order compelling petitioner to respond to respondent's interrogatories or for an order imposing sanctions under Rule 104 and a motion for an order compelling petitioner to respond to respondent's request for production of documents or for an order imposing sanctions under Rule 104. On November 21, 1985, the Court issued an order directing petitioner to answer respondent's interrogatories and to produce documents requested by respondent's counsel. A copy of such order was served on petitioner by the Court on November 22, 1985. Petitioner did not comply with the Court's order to answer respondent's interrogatories or produce any documents.

On November 26, 1985, the instant case was called from the calendar at Portland, Ore. Petitioner failed to appear. At that time, counsel for respondent moved to dismiss the instant case for failure to properly prosecute. The instant case was recalled for trial on November 27, 1985, at which time petitioner again did not appear. The case proceeded to trial on the fraud issue. Respondent introduced several documents into evidence and called as a witness the corporate payroll manager of Publishers' Paper Company. The Court then informed respondent's counsel that respondent's motion to dismiss would be granted and that respondent was to submit a memorandum of points and authorities with respect to the issue of petitioner's liability under section 6653(b). Such memorandum was duly filed.

OPINION

We first address respondent's motion to dismiss for failure to properly prosecute. Both Rule 123(b) and Rule 149(a) are relevant herein. Rule 123(b) provides:

> **Dismissal:** For failure of a petitioner properly to prosecute or to comply with these Rules or any order of the Court or for other cause which the Court deems sufficient, the Court may dismiss a case at any time and enter a decision against the petitioner. The Court may, for similar reasons, decide against any party any issue as to which he has the burden of proof; and such decision shall be treated as a dismissal for purposes of paragraphs (c) and (d) of this Rule.

Rule 149(a) provides as follows:

> **Attendance at Trials:** The unexcused absence of a party or his counsel when a case is called for trial will not be ground for delay. The case may be dismissed for failure properly to prosecute, or the trial may proceed and the case be regarded as submitted on the part of the absent party or parties.

No excuse was offered by petitioner as to his failure to appear at trial. As indicated above, the place of trial was designated by petitioner. In addition, the notice setting trial placed him on notice of the consequences of his unexcused absence. Furthermore, petitioner failed to comply with the November 21, 1985 order of the Court directing him to answer to respondent's interrogatories and to produce the requested documents. In light of petitioner's conduct in this proceeding and his failure to appear when the instant case was called for trial, respondent's motion to dismiss is granted. A decision against petitioner will therefore be entered with respect to the underlying deficiency as set forth in the notice of deficiency.

We now turn to respondent's determination that petitioner is liable for an addition to tax for fraud under section 6653(b). Section 6653(b) provides that there shall be added to the tax an amount equal to 50 percent of the underpayment of tax if any part of the underpayment is due to fraud. Sec. 6653(b). Respondent bears the burden of proving by clear and convincing evidence that petitioner underpaid his tax, and that some portion of this underpayment was due to fraud. Rule 142(b); Hebrank v. Commissioner, 81 T.C. 640, 642 (1983).

The record establishes that petitioner earned wages and failed to properly report them as income or to pay the taxes due on them. The element of underpayment is therefore established. See sec. 6653(c). What remains for consideration is whether that underpayment was due to fraud. The inquiry turns on whether the record establishes an intentional wrongdoing motivated by the specific purpose of evading a tax known or believed by petitioner to be owing, as evidenced by conduct intended to conceal, mislead, or otherwise prevent the collection of such tax. Gajewski v. Commissioner, 67 T.C. 181, 200 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978); Rowlee v. Commissioner, 80 T.C. 1111, 1123 (1983).

The existence of fraud is a question of fact to be determined upon consideration of the entire record. Gajewski v. Commissioner, supra at 199. While fraud may never be presumed, Beaver v. Commissioner, 55 T.C. 85, 92 (1970), it may be proven by circumstantial evidence. Rowlee v. Commissioner, supra at

1123. Petitioner's filing of Forms W-4 on which he falsely claimed that he had not owed taxes in the prior year, and that he did not expect to be liable for tax in the current year is a transparent effort to defraud the Federal government. See Hebrank v. Commissioner, supra. Petitioner had properly filed Federal income tax returns in the years prior to the year in issue. He knew that he was liable for Federal income tax in the prior years and that he would be liable for Federal income tax for the year in issue. Furthermore, the document which petitioner filed for 1980 showed a deliberate and fraudulent act on his part. Such Form 1040 showed an item of deduction which we have held repeatedly to be improper. See, e.g., Beard v. Commissioner, 82 T.C. 773 (1984); Moore v. Commissioner, T.C. Memo. 1983-20, affd. 722 F.2d 193 (5th Cir. 1984); Speck v. Commissioner, T.C. Memo. 1982-704. We are convinced that petitioner knew such deduction to be false and improper, and intended to defraud the government by deliberately claiming such false deduction. Moreover, petitioner improperly claimed a refund of income and FICA taxes withheld. We are convinced that petitioner intended to submit such Form 1040 for the sole purpose of misleading respondent's employees into paying petitioner's claimed amount of refund. Such deception was exposed and a notice of deficiency was issued. In light of petitioner's conduct with regard to the Form 1040 filed for 1980 and the false information certified to in the Forms W-4, we are convinced that petitioner intended to evade Federal income tax which he knew to be due and owing. Accordingly, we sustain respondent's imposition of an addition to tax under section 6653(b).

Having determined that petitioner is liable for the addition to tax under section 6653(b), we need not address respondent's alternative argument of negligence under section 6653(a).

To reflect the foregoing,

Appropriate order and

decision will be entered.

COMPLETED
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T. C. Memo. 1986-185

UNITED STATES TAX COURT

CLYDE ROLAND AMSLER, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 17853-83. Filed May 5, 1986.

During the taxable years in issue, petitioner worked as a musician. As leader of the musical group, petitioner executed contracts for the group's performances. Certain contracts were executed by petitioner on behalf of a trust entity in an attempt to assign petitioner's income to the trust.

Held, petitioner is liable for deficiencies in income taxes for unreported income received by the trust as compensation for his personal services as a musician. Held further, petitioner is liable for self-employment taxes attributable to the unreported income. Held further, petitioner is liable for an addition to tax under sec. 6651(a)(1), I.R.C. 1954, for failure to file timely his Federal income tax return. Held further, petitioner is liable for additions to tax under sec. 6653(a) for negligence or intentional disregard of rules and regulations.

Clyde Roland Amsler, pro se.

Jonathan J. Ono, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

STERRETT, Chief Judge: Respondent determined by separate notices of deficiency dated April 5, 1983 deficiencies in the Federal income taxes of petitioner and additions to tax for the taxable years ended December 31, 1979 and December 31, 1980 as follows:

		Additions to Tax	
Taxable Year	Deficiency	Sec. 6651(a)(1)[1]	Sec. 6653(a)
1979	$5,291.00	$529.10	$264.55
1980	3,710.00	--	186.00

After concessions, the issues for decision are whether petitioner has unreported compensation income for personal services as a musician, and whether petitioner is liable for self-employment taxes attributable thereto, for the 1979 and 1980 taxable years. Also at issue is whether petitioner is liable for additions to tax under section 6651(a)(1) for the 1979 taxable year for failure to file timely his Federal income tax return and under section 6653(a) for the 1979 and 1980 taxable years for negligence or intentional disregard of rules and regulations.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulated facts and exhibits attached thereto are incorporated herein by this reference.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the taxable years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Petitioner, Clyde Roland Amsler, resided in Virginia City, Nevada at the time he filed his amended petition in this case. Petitioner filed Federal income tax returns for the 1979 and 1980 taxable years, listing his filing status as "married filing separate return." Petitioner's 1979 return was signed on June 14, 1980 and received by respondent on June 17, 1980.

During 1979 and 1980 petitioner worked as a musician and was the leader of a Dixieland musical group, which performed under various names as stated below. In 1979 petitioner and his group performed at Cactus Pete's Horseshu Club (the Horseshu Club) located in Jackpot, Nevada, and at the Eldorado Hotel-Casino (the Eldorado) located in Reno, Nevada. In 1980 petitioner and his group performed at Pier 67 Inc. (the Edgewater Inn) located in Seattle, Washington.

Petitioner, as leader of the musical group, executed the contractual agreements for the group's performances. The contract with the Horseshu Club was signed by petitioner and listed the group's name as "Clyde Amsler." The contract with the Eldorado also was signed by petitioner, on behalf of Calza Trust, for performances by "Clyde Amsler's Dixielanders." Two separate contracts were executed with the Edgewater Inn by petitioner, on behalf of Calza Trust, for performances by the "Clyde Amsler Trio."

Calza Trust (the Trust) was formed as a Nevada trust on November 24, 1978 by petitioner as grantor. The Declaration of Trust (trust instrument) named Lois Zener Amsler, petitioner's wife, and Betty M. DeBard, petitioner's wife's sister, as its joint tenants in fee simple and its trustees. At trial, petitioner testified that he also was a trustee of the Trust.

The trust instrument granted broad powers to the trustees, as follows:

> DECLARATION OF AUTHORITY
>
> * * *
>
> The Trustees shall have all the powers necessary, convenient or appropriate to effectuate the purposes of the Trust, and may take any action which they deem necessary or desirable and proper to carry out such purposes. Any determination of the purposes of the Trust made by the Trustees in good faith shall be conclusive. In construing the provisions of this Trust Indenture Declaration, the Trustees' Regulations and the Trust Minutes, the presumption shall be in favor of the grant of powers to the Trustees.

The trust instrument provided that the purpose of the Trust was as follows:

> DECLARATION OF PURPOSE
>
> * * *
>
> The terms and conditions of this Trust Organization Indenture shall provide, under a common law right to contract, the pursuit of personal happiness and the maximizing of lifetime efforts and the protection of an estate in order to promote the general welfare and achieve a life purpose and according to any personal moral or religious beliefs, which are all sustained by this Trust Organization.
>
> TO WIT:
>
> Whereas the Life Purpose is to sustain, protect and improve this Trust Organization for the Trust Certificate Holders to possess the things of this life sufficient to provide for growth, health, protection, education, refinement, recreation, welfare, expansion, preservation and continuation, it is believed that to fail to plan for such things will certainly cause failure of the estate purpose. Therefore, it is proposed to use this Trust Organization as a plan for the achievement and improvement of a Life Purpose. This Trust Organization and the Life Purpose is sustained by Moral Belief that man is under a great

> Universal Spirit to replenish the earth and subdue it and have dominion over every living thing that moveth upon the face of the earth. Thus it is a Moral Belief that all are under a Divine Mandate to establish and care for and provide a Life Estate.

The Trust was formed by petitioner and other members of his family to preserve and maximize the estates of petitioner and his wife for the benefit of their estates' beneficiaries. At trial, petitioner testified that the Trust was formed by petitioner, his spouse and "other trustees" when he and his spouse were approximately 64 years old "in order to best perpetuate [and] enhance * * * [their] estate[s]." He continued, "We have committed our lifelong services to this trust. * * * We are doing this for our heirs, we issued beneficial certificates to them, and I hold a minority of those. [Petitioner's wife] Lois and her three children and my three children hold, by far, the majority of the beneficial interests. Upon our demise, they will come into the trust; they will be owners and trustees of the trust. * * * [W]e formed this trust in a sincere means, knowing that we're in the final phase of our lives. We've done this for a just purpose and for a sincere motivation." Petitioner added that "virtually everything" that he and his wife owned were conveyed to the Trust, including their real estate, personal property and musical instruments.

At trial, petitioner stated that a separate Mastercard charge account and bank account were kept for the Trust to be used exclusively for trust purposes. However, the accounts were maintained by petitioner and his wife. Also, petitioner and his wife were the persons authorized to draw checks on the bank account. Trust funds were to be used "[f]or purposes pertaining to the trust's business, only," in accordance with the "good judgment" of its trustees, again, petitioner, his wife and her sister. Trust expenditures were directed by its Board of Trustees, of which petitioner was a member.

In the statutory notices of deficiency, respondent determined deficiencies in petitioner's Federal income taxes for the 1979 and 1980 taxable years based upon petitioner's failure to report income received by the Trust as compensation for his personal services as a musician. The deficiencies were based in part on petitioner's liability for self-employment taxes on the unreported income. Respondent also determined additions to tax under section 6651(a)(1) for the 1979 taxable year and under section 6653(a) for the 1979 and 1980 taxable years.

OPINION

The primary issue for decision is whether petitioner has unreported income for compensation received by the Trust for petitioner's personal services as a musician. Respondent has determined deficiencies in the amounts of $5,291 and $3,710 in petitioner's Federal income taxes, based on unreported income in the amounts of $16,200 and $12,158 for the 1979 and 1980 taxable years, respectively. The parties have stipulated that, of the total amounts of the unreported income, $10,140 for 1979 and $5,250 for 1980 were paid to the other members of petitioner's musical group. Therefore, income in the amounts of $6,060 and $6,908 only remain in issue for the 1979 and 1980 taxable years, respectively.

Petitioner argues that the amounts received for his musical performances do not constitute income to petitioner, but rather are taxable to, and in fact were reported by, the Trust.[2] Respondent argues that the income is taxable to petitioner as the true earner of the compensation. Petitioner bears the burden of proof on this issue. Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933).

A taxpayer cannot escape taxation by an assignment of his or her income to another entity. Lucas v. Earl, 281 U.S. 111, 114-115 (1930). A fundamental principle of our income tax laws is that income is taxed to the one who earns it, Commissioner v. Culbertson, 337 U.S. 733, 739-740 (1949), and taxation cannot be avoided by diverting the income to another entity, for example to a trust, as in the instant case. United States v. Basye, 410 U.S. 441, 450 (1973).

The Trust was formed by petitioner and other members of his family to preserve and maximize the estates of petitioner and his wife for the benefit of their estates' beneficiaries. The mere fact that the contracts for performances by petitioner were executed on behalf of the Trust, rather than in petitioner's own name, does not serve to shift the incidence of taxation away from petitioner for Federal income tax purposes. The proper taxpayer is not necessarily the recipient of the income, but rather is the person who has control over the earning of the income. Wesenberg v. Commissioner, 69 T.C. 1005, 1010-1011 (1978). The contracts executed by petitioner, on behalf of the Trust, with the Eldorado and the Edgewater Inn were negotiated by the trustees, that is, by petitioner, his wife, and his wife's sister. Petitioner cannot escape taxation for his personal services as a musician by this attempted transfer of his lifetime services to the Trust nor by his execution of contracts for his musical performances on behalf of the Trust entity. See Duncan v. Commissioner, 756 F.2d 747, 748 (9th Cir. 1985), affg. per curiam an unpublished order of this Court; Hicks v. Commissioner, 718 F.2d 1110 (9th Cir. 1983), affg. without published opinion a Memorandum Opinion of this Court.

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[2] At trial, petitioner testified that all of the income in issue was reported by the Trust on its Federal income tax returns (Forms 1041). However, when questioned by the Court with respect to whether a set-off against taxes paid by the Trust would be appropriate, petitioner replied that the Trust operated at a loss for the taxable years in issue, and, therefore, did not pay any taxes.

The sole case relied upon by petitioner is Laughton v. Commissioner, 40 B.T.A. 101 (1939). In Laughton, the taxpayer had executed a contract with a corporation, Motion Pictures and Theatrical Industries, Limited (the corporation), who then loaned out the taxpayer's services as a movie actor. This Court found that the taxpayer's "only relationship with the contracts for the loaning of his services was to consent to the performance of the services provided for in such loan contracts" and that there was no assignment of the taxpayer's income. Laughton v.

Commissioner, supra at 106-107. Therefore, we concluded that the income received by the corporation was not taxable to the taxpayer individually.

The facts in Laughton clearly are distinguishable from those in the instant case. Here, petitioner, and not the Trust, is the true earner of the income received for his performances as a musician. Petitioner's control over the earning of his income is evidenced by the fact that he was one of the trustees who negotiated the contracts for his musical performances. Also, petitioner's control over the Trust's activities is demonstrated by his access to trust funds and direction over trust expenditures.

Petitioner's conveyance of virtually all of his property interests to the Trust, and execution of contracts for his personal services in the name of the Trust, constitute an attempt to assign his income to the Trust, which cannot be respected for Federal income tax purposes. We conclude that amounts received by the Trust as compensation for petitioner's personal services as a musician are taxable to petitioner under section 61.[3] Accordingly, we sustain respondent's determinations of deficiencies in petitioner's Federal income taxes based upon petitioner's failure to report income received by the Trust as compensation for his personal services.[4]

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[3] SEC. 61. GROSS INCOME DEFINED.
(a) General Definition.--Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
(1) Compensation for services, including fees, commissions, and similar items; * * *.

Respondent also determined deficiencies in petitioner's taxes based on petitioner's liability for self-employment taxes on the unreported income for the 1979 and 1980 taxable years. Section 1401 imposes a tax on income derived from self-employment, as defined in section 1402.[5] Petitioner argues that no self-employment taxes are due as he did not earn any self-employment income during the taxable years in issue. Respondent argues that petitioner is liable for self-employment taxes because he worked as an independent contractor. Petitioner bears the burden of proof that he is not liable for any self-employment taxes. _Simpson v. Commissioner_, 64 T.C. 974, 983 (1975).

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[4] The record is unclear to the extent to which petitioner may have reported income with respect to amounts received by the Trust. Petitioner has maintained that the income in issue is that of the musical group and therefore not his personal income. However, we note that petitioner has reported income based on Forms 1099-NEC from Calza Trust in the amounts of $3,120 and $3,600 for the 1979 and 1980 taxable years, respectively, which petitioner characterizes as income for professional services as a trustee of the Trust. To the extent that these amounts reported represent compensation to petitioner for his services as a musician under the contracts executed on behalf of the Trust, they are to be taken into account in the computations of the deficiencies under Rule 155.

[5] Section 1402 provides in relevant part as follows:

> SEC. 1402. DEFINITIONS.
>
> (a) Net Earnings From Self-Employment.--The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, * * *.
>
> (b) Self-Employment Income.--The term "self-employment income" means the net earnings from self-employment derived by an individual (other than a nonresident alien individual) during any taxable year; * * *.
>
> (c) Trade or Business.--The term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses), except that such term shall not include--

(footnote continued)

Self-employment taxes are imposed where an individual works as an independent contractor, _Simpson v. Commissioner_, _supra_ at 988-989. However, self-employment taxes are not imposed on income or net earnings from a trade or business for "the performance of service by an individual as an employee," subject to certain statutory exceptions that are not applicable here. Section 1402(c)(2). The issue of whether a taxpayer is an independent contractor or an employee is a factual question, and among the factors to be considered is the degree of control exercisable by the taxpayer over the details of the work involved. _Simpson v. Commissioner_, _supra_ at 984-985. As stated above, petitioner clearly exercised control over the earning of his income. Additionally, at trial, when asked by the Court whether he was self-employed, petitioner stated, "I was working

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(footnote continued from previous page)

* * *

> (2) the performance of service by an individual as an employee, * * *.

as an independent contractor, under the auspices of the trust." Accordingly, we sustain respondent's determinations that petitioner is liable for self-employment taxes.

Respondent also determined that petitioner is liable for an addition to tax under section 6651(a)(1)[6] for the 1979 taxable year for failure to file timely his 1979 Federal income tax return. Petitioner bears the burden of proof that the failure to file the return timely was due to reasonable cause. Horton v. Commissioner, 86 T.C. ___ (April 3, 1986)(slip op. at 13-14); Richardson v. Commissioner, 72 T.C. 818, 827 (1979). Reasonable cause exists where a taxpayer has "exercised ordinary business care and prudence." Sec. 301.6651-1(c)(1), Proced. & Admin. Regs.

We conclude that petitioner has failed to demonstrate reasonable cause for the late filing of his 1979 return. Petitioner's 1979 return, prescribed to be filed as of April 15,

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[6] Section 6651 provides in relevant part as follows:

> SEC. 6651. FAILURE TO FILE TAX RETURN OR TO PAY TAX.
> (a) Addition to the Tax.--In case of failure--
> (1) to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), * * * on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate; * * *.

1980, was dated June 14, 1980 and received by respondent on June 17, 1980. Petitioner states that he "realized belatedly" that income to the Trust "erroneously" had been assigned to him personally, and that he needed additional time to request and receive "corrected" Forms 1099-NEC designating the Trust as the proper recipient of the income. However, petitioner did not request any extension of time to file his return. Moreover, petitioner's mistaken belief that he is not taxable does not constitute reasonable cause. See Henningsen v. Commissioner, 26 T.C. 528, 536 (1956), affd. 243 F.2d 954, 958-959 (4th Cir. 1957).[7] Accordingly, we sustain respondent's determination of an addition to tax under section 6651(a)(1).

Respondent also determined that petitioner is liable for additions to tax under section 6653(a)[8] for the 1979 and 1980 taxable years due to negligence or intentional disregard of rules and regulations. Petitioner bears the burden of proof that the additions have been imposed improperly. Tomburello v. Commissioner, 86 T.C. ___ (Mar. 31, 1986)(slip op. at 11); Catalano v. Commissioner, 81 T.C. 8, 17 (1983), affd. without published opinion sub nom. Knoll v. Commissioner, 735 F.2d 1370 (9th Cir. 1984).

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[7] See also Estate of Cady v. Commissioner, T.C. Memo. 1979-318, affd. by unpublished opinion 634 F.2d 631 (8th Cir. 1980); Anthony v. Commissioner, T.C. Memo. 1976-302, affd. by unpublished opinion 566 F.2d 1168 (3d Cir. 1977); Nelson v. Commissioner, T.C. Memo. 1974-239.

[8] Section 6653 provides in relevant part as follows:

> SEC. 6653. FAILURE TO PAY TAX.
> (a) Negligence or Intentional Disregard of Rules and Regulations With Respect to Income * * * Taxes.--If any part of any underpayment * * * is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.
>
> * * *

Petitioner argues that the determined additions to tax are invalid, as all of the income in dispute has been reported and all taxes due have been paid. However, as stated above, there are deficiencies in petitioner's Federal income taxes for the 1979 and 1980 taxable years. The imposition of additions to tax under section 6653(a) is appropriate where a taxpayer attempts to deflect his or her tax liability by an assignment of income to another entity. Duncan v. Commissioner, 756 F.2d 747, 748 (9th Cir. 1985), affg. per curiam an unpublished order of this Court. Therefore, we sustain respondent's determinations of additions to tax under section 6653(a).

Decision will be entered
under Rule 155.

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T. C. Memo. 1986-186

UNITED STATES TAX COURT

MARSHALL HERBERT AND VIRGINIA HELTON HICKEY, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 11615-84. Filed May 6, 1986.

Marshall Herbert Hickey, pro se.

Nancy W. Hale, for the respondent.

MEMORANDUM OPINION

GUSSIS, Special Trial Judge: This case was assigned to Special Trial Judge James M. Gussis pursuant to section 7456(d)(3) of the Internal Revenue Code of 1954 and Rules 180, 181, and 182 of the Tax Court Rules of Practice and Procedure.[1]

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Respondent determined a deficiency in petitioners' Federal income tax for the year 1980 in the amount of $1,149.85. The sole issue for determination is whether petitioners are entitled to a residential energy credit for $1,149.85 under section 44C(a)(2).[2]

Some of the facts have been stipulated and are found accordingly. Petitioners resided in Knoxville, Tennessee at the time they filed their petition.

During 1980, petitioners installed a self-designed heating and cooling system in their residence. The system utilized water from the nearby Melton Hill Reservoir at temperatures between 43 degrees Fahrenheit (approximately 6 degrees Celsius) and 73 degrees Fahrenheit (approximately 23 degrees Celsius) for heating and cooling the petitioners' home. On their joint 1980 Federal income tax return, petitioners claimed an energy credit in the amount of $1,149.85. Respondent, in his notice of deficiency, disallowed the claimed credit on the ground that the ground water heat pump (system) did not meet the requisite definition of "renewable energy source property" pursuant to section 44C.

Section 44C allows a credit to individual taxpayers for qualified energy source expenditures made with respect to renewable energy source property. Section 44C(a)(2). Renewable energy source property includes property which transmits or uses energy derived from geothermal deposits. Section 44C(c)(5)(A)(i). Under section 44C(c)(6)(A)(i), the Secretary is empowered to issue regulations which establish criteria to be used in prescribing performance and quality standards for renewable energy source property. Pursuant to this authority, regulations were promulgated (sec. 1.44C-2(h), Income Tax Regs.) which defined "geothermal energy property" to include:

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[2] Section 44C was redesignated as section 23 by section 471(c) of the Deficit Reduction Act of 1984, 98 Stat. 826, effective for taxable years beginning after December 31, 1983.

> equipment * * * necessary to transmit or use energy from a geothermal deposit to heat or cool a dwelling * * *. A geothermal deposit is a geothermal reservoir consisting of natural heat which is from an underground source and is stored in rocks or in an aqueous liquid or vapor (whether or not under pressure), having a temperature exceeding 50 degrees Celsius as measured at the wellhead * * * [Emphasis added.]

The parties have stipulated that the petitioners' heating and cooling equipment utilized ground water at temperatures between 6 degrees Celsius and 23 degrees Celsius for heating and cooling the petitioners' home. It is evident therefore that the system does not qualify as geothermal property under the regulations. The fact that the system may be energy efficient is, by itself, irrelevant to a determination of whether such property qualifies for the residential energy credit under section 44C(a)(2). See Reddy v. Commissioner, T.C. Memo 1984-395, affd. per order (4th Cir. Aug. 29, 1985).

Petitioner argues that the regulations do not reflect the intention of Congress. However, similar arguments have been previously considered and rejected by this Court. Peach v.

Commissioner, 84 T.C. 1312 (1985), on appeal (4th Cir., Sept. 13, 1985). Congress indicated what it meant by geothermal energy in the Committee Report that accompanied the passage of the Energy Tax Act of 1978 (92 Stat. 3174). The Senate Report defines geothermal equipment as equipment necessary to distribute or use geothermal steam and associated geothermal resources (as defined in section 2(c) of the Geothermal Steam Act of 1970; 30 U.S.C. sec. 1001(c) (1982)). As stated therein, geothermal reservoirs consist of natural heat stored in rocks or an aqueous liquid or vapor (whether or not under pressure), including hot brine, dry heat, and hot water. S. Report No. 95-529 (1977), 1978-3 C.B. (Vol. 2) 199, 232. It appears, therefore, that the regulations do reflect the intent of Congress in enacting section 44C. We have no authority to go beyond the explicit terminology of the statute. See Donigan v. Commissioner, 68 T.C. 632, 636 (1977). We must conclude on this record that petitioners are not entitled to a residential energy credit under section 44C(a)(2) in the year 1980.

Decision will be entered
for the respondent.

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T. C. Memo. 1986-187

UNITED STATES TAX COURT

RAYMOND BOOTH and CANDICE BOOTH, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 33254-84. Filed May 6, 1986.

Raymond Booth and Candice Booth, pro se.

Albert K. Kerkhove, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, Judge: By separate notices of deficiency, respondent determined deficiencies in petitioners' Federal income taxes for 1981 and 1982 as follows:

		Additions to Tax			
Year	Deficiency	Sec. 6651(a)(1)[1]	Sec. 6653(a)(1)	Sec. 6653(a)(2)	Sec. 6654
Raymond L. Booth and Candice A. Booth					
1981	$5,229.50		$ 261.48	*	
Raymond L. Booth					
1982	650.00	$ 135.00	33.00	**	51.00
Candice A. Booth					
1982	5,345.00	1,336.00	276.00	***	520.00

* 50 percent of the interest due on $5,229.50
** 50 percent of the interest due on $540.00
*** 50 percent of the interest due on $5,345.00

After concessions, the issues for decision are whether income attributed by respondent to petitioner Candice A. Booth was in fact income of a corporation and whether that income should be reduced by payments made to various individuals.

FINDINGS OF FACT

Some of the facts have been stipulated, and the stipulation of facts are incorporated herein by this reference.

Petitioners were residents of Omaha, Nebraska, at the time they filed their petition herein. They filed a joint Federal income tax return for 1981 but did not file any income tax returns for 1982. During those years petitioner Candice A. Booth (petitioner) operated a bookkeeping business.

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

During 1979, petitioner acquired the stock in a corporation known as Double M Shop, Inc. (the corporation). The corporation elected a fiscal year ending January 31. The corporation did not maintain a separate bank account prior to 1982. During 1981, income received from the business operated by petitioner was deposited into a bank account maintained individually by petitioners. Business expenses, as well as personal expenses, were paid out of that bank account. At the end of 1981, petitioner decided that the income earned by the business during 1981 would be treated as corporate income. She reported that income on a corporate return. During 1982, petitioner opened a separate bank account for the corporation. The corporation did not file a tax return for its fiscal year ended January 31, 1983.

During 1982, petitioner operated a tax return preparation service. Petitioner had succeeded her father, Charles Newell, as the operator of that business. In relation to that business, during 1982, petitioner made payments to the following persons:

Person	Amount
Karen Lancaster	$ 100.00
Charles Newell	5,689.70
Bud Deats	450.00
Linda Hirsch	20.00
Linda Kowaleski	23.29
Jean Deats	86.00
Linda Nord	36.20
Ralph Deats	150.00
Gene Tompkins	25.00
Total	$6,580.19

OPINION

Petitioners bear the burden of proving that the determinations in the statutory notices of deficiency are incorrect. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a), Tax Court Rules of Practice and Procedure. Petitioners presented evidence only with respect to their claim that income from the bookkeeping and tax preparation businesses was corporate income and that the above payments made during 1982 constituted deductible business expenses. They presented no evidence as to other matters, including the additions to tax. Thus all other issues not conceded by respondent must be resolved against petitioners.

With respect to the business income, petitioner testified as follows:

> THE WITNESS: The customers were friends, mostly, to begin with; and, referrals from friends that liked what I did. I had worked for a CPA and when I left him, a couple of the clients that the CPA had showed a preference for me. And, they also became my clients.
>
> And then, in 1982, my father retired and more or less dumped his whole business in my lap; and, that is

> when I knew that I needed a separate bank account to keep things separate.
>
> * * *
>
> THE COURT: Well, was there anything that distinguished what you did in 1981, in fact, with what you would have done if you had, had a Schedule C Proprietorship business?
>
> THE WITNESS: No, I don't assume so. Not in '81. Because I was not sure whether I was really going to have a business, or not.
>
> But, at the end of the year, I considered it as the corporation money. I claimed it as the corporation money on the proper return. I took all of the expenses, properly, on the corporation return.

Petitioner presented no evidence that any customer dealt with the corporation or that the corporation was anything other than a mere nominee to which she unilaterally decided to assign income that she had earned as an individual. The income, therefore, is taxable to her and not to the corporation regardless of whether the corporation is otherwise a separate entity. See, e.g., Saenger v. Commissioner, 69 F.2d 631 (5th Cir. 1934).

With respect to the payments claimed to be deductible expenses of the business, petitioner testified without contradiction that they were for services performed by the payees on behalf of the business. Respondent's only comment with respect to nondeductibility was that the payments made to Charles Newell might be in exchange for the business rather than payment for services. The evidence of record, however, is sufficient to satisfy petitioner's burden of proof.[2] Petitioners are entitled to deduct the payments totaling $6,580.19.

Decision will be entered

under Rule 155.

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[2] We take judicial notice that the case of Charles F. Newell, docket No. 24219-84, involved his tax liability for 1982 and was set for trial at the same time and place as the within case. Newell's motion to continue his case and to change the place of trial to Las Vegas, Nevada, was endorsed "no objection" by respondent on February 13, 1986, approximately a month before the trial date. Apparently respondent did not believe that Newell's testimony would be helpful to respondent in this case. Petitioner testified that she had not had any contact with Newell for quite awhile, so we do not draw any inferences from her failure to call him.

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ORIGINAL

T. C. Memo. 1986-188

UNITED STATES TAX COURT

EDWARD RAY DOUGHERTY, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 1611-82.   Filed May 8, 1986.

Edward Ray Dougherty, pro se.

Thomas P. O'Driscoll, for the respondent.

MEMORANDUM OPINION

SHIELDS, Judge: Respondent determined a deficiency of $3,563 in the income tax due from petitioner for 1978. After concessions, the issues for decision are: (1) whether petitioner is entitled to deduct rental expenses in excess of those allowed by respondent, and (2) whether petitioner may deduct certain automobile and truck expenses as well as union dues as business expenses.

For convenience, our findings of fact and opinion are combined. Some of the facts have been stipulated and are so found. The stipulation and exhibits attached thereto are incorporated herein by reference.

Petitioner resided in St. Louis, Missouri, during 1978 and at the time he filed the petition in this case. He timely filed an income tax return for the year 1978 with the Internal Revenue Service Center at Kansas City, Missouri.

During 1978, petitioner earned $10,732.64 as a forklift operator for General Motors Truck and Bus Assembly Plant. The plant is located approximately seven miles from petitioner's residence. In connection with this employment, petitioner paid $148 in union dues during 1978. The dues were withheld from his paychecks.

During 1978, petitioner owned four three-story apartment buildings located at 2751, 2753, 2755 and 2757 Russell Boulevard, a poor, run-down and blighted area of St. Louis. The buildings were old and needed repairs. Each building contained a total of nine rooms which were divided into three residential units of two to four rooms each. Each building was heated with a coal furnace located in the basement.

Petitioner resided in one of the units at 2755 Russell Boulevard. All of the other units were available for rent or were used for storage by petitioner. During 1978 some of the rental units were vacant for various periods of time.

On his 1978 return petitioner reported rental income totaling $5,810.00 and claimed deductions for rental expenses totaling $14,342.00 for a net loss on the rental properties of $8,532.00. Of the rental deductions claimed by petitioner, respondent allowed a total of $8,600.50 and disallowed a total of $5,741.50. The rental expenses claimed by petitioner and disallowed by respondent are as follows:

	Rental Expenses	
	Claimed By Petitioner	Disallowed By Respondent
Cleaning	$1,600.00	$1,600.00
Linen	470.00	470.00
Furnace	168.00	168.00
Painting	930.00	925.50
Roof	735.00	735.00
Hardware	144.00	144.00
Pest Control	147.00	147.00
Supplies	232.00	232.00
Depreciation--Furniture	1,008.00	1,008.00
Miscellaneous	312.00	312.00
TOTAL	$5,746.00	$5,741.50

At trial, petitioner was unable to produce the names of any of his tenants during 1978 and in support of the disallowed expenses, he submitted only some handwritten receipts. He testified that the receipts were received from tenants and third parties whom he had hired from time to time to do various odd jobs with respect to the rental properties. He further testified that the receipts for the cost of the furniture on which he claimed depreciation were also received by him from former tenants and other parties from which he had purchased used furniture. However, petitioner's entire testimony was vague and somewhat contradictory and the authenticity of the receipts produced by him are highly questionable especially in view of his refusal to permit respondent to examine them before trial and his inability to produce any former tenant or other person in their support. Consequently, we are unable to conclude that he has carried his burden of proving that he is entitled to a deduction for any rental expenses in excess of those allowed by respondent. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a).[1]

On his return petitioner also claimed a deduction on Form 2106 for employee business expenses totaling $2,506.00 for the following items:

Tax Service	$ 144.00
Automobile and Truck Expense	2,162.00
Union Dues	148.00
Safety Shoes	40.00
Maintenance	12.00
TOTAL	$2,506.00

Respondent originally disallowed the above deduction in its entirety, but at trial he conceded the deduction to the extent of the tax service, safety shoes and maintenance, although they were incorrectly claimed on Form 2106.

In support of the automobile and truck expense the record contains nothing but petitioner's vague, confusing and often contradictory testimony and some uncorroborated receipts for gas and other vehicle expenses. None of the receipts reflect petitioner as the payee, although some of them are made out to "Ray's Auto Sales" which may be a related entity, but no explanation appears in the record. Furthermore, petitioner offered no competent evidence in support of his allocation of 90 percent of his alleged truck expense to business use or of how he arrived at the estimate of his car expenses. We conclude, therefore, that petitioner has failed to carry his burden of proving that he is entitled to any deduction for automobile and truck expenses in excess of those conceded by respondent.

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[1] All section references are to the Internal Revenue Code of 1954, as amended, during the year in issue unless otherwise indicated. All rule references are to the Tax Court Rules of Practice and Procedure unless otherwise provided.

Petitioner also contends, however, that at least part of the automobile and truck deduction is allowable for the 14 miles he traveled each workday between two jobs (his job at General Motors and his rental properties where he resided).

Expenses incurred in traveling between two businesses are deductible under some circumstances. See Steinhort v. Commissioner, 335 F.2d 496 (5th Cir. 1964) and Heuer v. Commissioner, 32 T.C. 947 (1959), affd. per curiam 283 F.2d 865 (5th Cir. 1960). However, where as here, the taxpayer's residence is located at the site of a minor place of business, the expenses of traveling between the minor business (his residence) and his major place of employment constitute nondeductible personal commuting expense. Mazzotta v. Commissioner, 57 T.C. 427, 429 (1971), affd. per curiam 465 F.2d 1399 (2d Cir. 1972); see also Curphey v. Commissioner, 73 T.C. 766, 777-778 (1980); Green v. Commissioner, 59 T.C. 456, 459 (1972).

Here there is no question but that petitioner's employment at General Motors was his principal place of business. In fact, petitioner does not argue otherwise. We conclude, therefore, that petitioner's transportation expenses between his home at the rental properties and his place of employment at General Motors were primarily personal in nature and are not deductible as a business expense. Commissioner v. Flowers, 326 U.S. 465 (1946).[2]

With respect to the union dues petitioner contends that they are deductible as a business expense because General Motors is a closed shop and he was required to belong to the union as a condition to his continued employment. Respondent does not challenge the amount of the deduction. He simply argues that such item is available only as an itemized deduction and not as a business expense. Respondent is correct. Cashman v. Commissioner, 9 T.C. 761 (1947). See also Stahlin v. Commissioner, a Memorandum Opinion of this Court dated October 3, 1952; Stuermer v. Commissioner, a Memorandum Opinion of this Court dated November 23, 1951.

Decision will be entered
under Rule 155.

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[2] See also Davis v. Commissioner, T.C. Memo. 1984-302.

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ORIGINAL

T. C. Memo. 1986-189

UNITED STATES TAX COURT

DENNIS H. WETTERHOLM AND GERALDINE A. WETTERHOLM ET AL.,[1]
Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 6081-81, 6082-81, 6163-81. Filed May 8, 1986.

Curtis Darling and George Manolakas, for the petitioners.

Michael C. Cohen, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: Respondent determined the following deficiencies in petitioners' Federal income taxes:

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[1] Cases of the following petitioners are consolidated herewith: David R. Martin and Sarah J. Martin, dkt. No. 6082-81; William F. Casteen and Helen V. Casteen, dkt. No. 6163-81.

Docket No.	Petitioner	Year	Deficiency
6081-81	Dennis H. and Geraldine A. Wetterholm	1976	$16,667
6082-81	David R. and Sarah J. Martin	1976	5,390
6163-81	William F. and Helen V. Casteen	1976	7,663

After concessions, the only remaining issue for decision is whether $60,327 paid by the Raintree Gardens partnership (the partnership) in 1976 as a discount and commitment fee to the Government National Mortgage Association (GNMA) may be fully deducted in the year paid. The outcome depends upon whether section 461(g)(1)[2] applies on these facts. If section 461(g)(1) is applicable, the GNMA fees paid by the partnership in 1976 must be capitalized and amortized over the life of the loan.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and the attached exhibits are incorporated herein by this reference. All petitioners resided in Bakersfield, California when they filed the petitions in these cases.

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[2] All statutory references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue.

Each of the petitioners is a limited partner in the Raintree Gardens partnership. The limited partnership agreement was executed by the various partners between May 24 and September 14 of 1976. Petitioners and the partnership are all cash basis taxpayers and report their income on a calendar year basis.

The partnership was formed for the purpose of constructing and operating a 68 unit apartment project in Bakersfield, California. The land on which the project was to be constructed was obtained pursuant to an option acquired in 1974 by Robert Matsumoto (Matsumoto) through his wholly-owned company, Dynamic Properties of California, Inc. Dynamic Properties of California, Inc. was itself the general partner of Raintree Gardens.

Following the acquisition of the parcel, Matsumoto contacted the mortgage banking firm of Molton, Allen & Williams, Inc. (Molton, Allen) of Birmingham, Alabama, with regard to obtaining financing for the project. Molton, Allen applied to the Department of Housing and Urban Development (HUD) for project mortgage insurance. The application for mortgage insurance was submitted on behalf of Matsumoto, the promoter of the project, because the partnership did not come into existence until September of 1976.

A conditional commitment was obtained from HUD in April of 1975. The conditional commitment obligates HUD to issue a firm commitment for mortgage insurance if the project develops in accordance with the specifications set forth in the application for the conditional commitment. On January 29, 1976, HUD issued a firm commitment to insure a mortgage of $1,340,600 for the Raintree Gardens project. HUD insures loans made by approved lenders under specified conditions and terms. HUD is not itself a lender, but instead plays the role of surety or guarantor to protect the mortgagee in the event of a later default by the borrower.

In addition, on July 20, 1976, GNMA issued a commitment to purchase the loan when fully disbursed by the lender and fully insured by HUD. The commitments from HUD and GNMA were originally issued to Molton, Allen on behalf of the partnership. In August of 1976, the commitments from HUD and GNMA were assigned by Molton, Allen to United California Mortgage Company, a division of the United California Bank.[3] Finally, on September 30, 1976, United California Bank entered into a written loan agreement with the partnership for a loan in the amount of $1,340,600 secured by a deed of trust. The term of the loan was 40 years.

On its 1976 Federal income tax return, the partnership claimed an interest expense deduction in the amount of $96,495.06. In the notices of deficiency respondent disallowed $91,804.70 of that amount. The parties subsequently agreed that additional expense items totalling $31,477.70 should properly be capitalized and amortized over the 40-year term of the loan commencing September 30, 1976. The balance of the interest deduction claimed by the partnership in 1976 consisted of $60,327 in fees paid in connection with the GNMA commitment to provide permanent financing. Respondent asserts that section 461(g)(1) requires that these fees be capitalized and amortized over the full term of the loan.

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[3] The United California Bank has since changed its name to First Interstate Bank of California.

OPINION

The Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520 which added section 461(g)(1) to the Code, provides that such section is not applicable to interest expenses paid pursuant to a binding contract or written loan commitment in existence on September 16, 1975. Respondent asserts that no such binding contract or written loan commitment existed as of this date. Therefore, respondent argues that section 461(g)(1) applies to the GNMA fees paid by the partnership.

Matsumoto acquired an undeveloped piece of property pursuant to an option. Matsumoto then initiated the process of obtaining permanent financing for a 68 unit garden apartment project on behalf of the partnership. On July 20, 1976, GNMA issued a commitment to purchase the loan after it was fully insured and after the loan funds had been disbursed. The partnership paid $60,327 in fees in order to obtain this permanent financing from

GNMA.[4] On September 30, 1976, the partnership entered into a written agreement with United California Bank for a loan in the amount of $1,340,600.

We must decide whether the $60,327 in fees paid by the partnership are properly deductible in 1976. Respondent concedes that the fees paid to obtain GNMA's commitment to provide permanent financing were in the nature of interest. See Wilkerson v. Commissioner, 655 F.2d 980 (9th Cir. 1981), revg. 70 T.C. 240 (1978); Goodwin v. Commissioner, 75 T.C. 424 (1980), affd. without published opinion 691 F.2d 490 (3d Cir. 1982); Baird v. Commissioner, 68 T.C. 115 (1977). Respondent contends however that the GNMA fees must be capitalized and deducted over the full term of the mortgage.

Section 163(a) provides that there shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness. Interest is defined as compensation paid for the use or forebearance of money. Deputy v. duPont, 308 U.S. 488 (1940). Section 461(g)(1) provides that cash basis taxpayers must capitalize prepaid interest and deduct it as if they were on the accrual method of accounting.[5] Thus, section 461(g)(1) requires that prepaid interest be allocated to the years in which the interest reflects a cost for the use or forebearance of money. Cf. *Beek v. Commissioner*, 80 T.C. 1024, 1029 (1983), affd. 754 F.2d 1442 (9th Cir. 1985); *Zidanic v. Commissioner*, 79 T.C. 651, 654 (1982); *Schubel v. Commissioner*, 77 T.C. 701, 703 (1981).

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[4] Generally speaking, mortgage lenders are divided into primary and secondary lenders. Primary lenders such as United California Bank, are often unwilling to restrict their monies for the full term of the loan. In these circumstances, the lender can sell the mortgage in the secondary mortgage market to GNMA or one of the other secondary lenders. Wofford, Real Estate 409 (1983 rev.).

Petitioners do not contest the effect that section 461(g)(1) would have if applied to the GNMA fees. Instead petitioners argue that these fees were paid in conjunction with a loan transaction that preceded the effective date of the provision. Section 461(g)(1) became effective as follows:

> (1) IN GENERAL.--Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to amounts paid after December 31, 1975, in taxable years ending after such date.
>
> (2) CERTAIN AMOUNTS PAID BEFORE 1977.--The amendment made by subsection (a) shall not apply to amounts paid before January 1, 1977, pursuant to a *binding contract or written loan commitment which existed on September 16, 1975* (and at all times

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[5] Sec. 461(g)(1) provides:

SEC. 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

* * *

(g) PREPAID INTEREST.--

(1) IN GENERAL.--If the taxable income of the taxpayer is computed under the cash receipts and disbursements method of accounting, interest paid by the taxpayer which, under regulations prescribed by the Secretary, is properly allocable to any period--

(A) with respect to which the interest represents a charge for the use or forbearance of money, and

(B) which is after the close of the taxable year in which paid,

shall be charged to capital account and shall be treated as paid in the period to which so allocable.

thereafter), and which required prepayment of such amounts by the taxpayer. [Section 208(b), Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1542. Emphasis added.][6]

It has been stipulated that the GNMA fees were paid prior to January 1, 1977. Thus, section 461(g)(1) will not apply if the fees were paid pursuant to a binding contract or a written loan commitment, which was in existence on or before September 16, 1975, (and at all times thereafter) and which required the prepayment of these fees by the partnership.

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[6] The legislative history of the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520, describes the effective date of sec. 461(g) as follows:

> The rules in this provision apply generally to any prepayment of interest after September 16, 1975, in taxable years ending after that date. However, a transition rule excepts interest paid before January 1, 1976 (even if the taxpayer's taxable year ends after that date) if there existed on September 16, 1975, and at all times thereafter, either (1) a binding written contract for a prepayment of interest by the taxpayer, or (2) a written loan commitment for a loan to the taxpayer (requiring prepaid interest if the taxpayer takes the loan). In either of these situations, however, if the interest is paid on or after January 1, 1976, the payment will be subject to this provision. [H. Rept. No. 94-658 (1975), 1976-3 C.B. (Vol. 2) 695, 793.]

The only modification to the House version of the effective date provision set out above involves the cut-off date of January 1, 1976, which was changed to January 1, 1978 by the Senate. S. Rept. No. 94-938 (1976), 1976-3 C.B. (Vol. 3) 49, 143. The House Conference Report indicates that a compromise was in fact reached and January 1, 1977, was ultimately agreed upon. H. Rept. No. 94-1515, (Conf.) 417 (1976).

The partnership did not enter into a binding contract with regard to the financing of the proposed apartment complex until September 30, 1976, when the loan was executed by United California Bank. Petitioners argue that although a binding contract did not exist, a written loan commitment was in existence on or before September 16, 1975. Petitioners contend that the transitional rule in the Tax Reform Act of 1976 referring to a written loan commitment entered into prior to September 16, 1975, relates to the stage in the lending process when both the lender and the borrower are, for all practical purposes, economically committed to the transaction. Petitioners argue that April 9, 1975, the date on which HUD's conditional commitment for project mortgage insurance was obtained, constituted the point at which all parties implicitly agreed that a viable project existed.

Conversely, respondent contends that the acquisition of the conditional commitment for project mortgage insurance does not constitute a "written loan commitment," because it does not warrant that a loan will ultimately be made. Respondent maintains that after receiving a conditional commitment a borrower still must negotiate a formal agreement with the lender. Furthermore, as of September 16, 1975, the loan in the instant case had not yet been approved by the bank's loan committee and the loan committee had the authority and the discretion to decline the loan. Thus, respondent argues that section 461(g)(1) should apply to the GNMA fees paid by the partnership and, as such, those fees must be amortized over the 40-year term of the loan. We agree with respondent.

Deductions are a matter of legislative grace. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). Petitioners must qualify under the specific rules and regulations imposed by Congress to properly claim a deduction. *Deputy v. duPont*, 308 U.S. 488 (1940). Respondent's notice of deficiency is presumed correct, and petitioners have the burden of proving otherwise. *Welch v. Helvering*, 290 U.S. 111 (1933); Rule 142(a), Tax Court Rules of Practice and Procedure.

Petitioners cannot succeed in this action because they have failed to provide evidence of any document that was in existence on or before September 16, 1975, that could be construed as a written commitment to make a loan to the partnership. Indeed, the partnership did not begin its legal existence until after September 16, 1975. The limited partnership agreement for Raintree Gardens was executed by the various parties between May 24, 1976, and September 14, 1976.

Cal. Code sec. 15502(1) (West 1984 Supp.) requires persons wishing to form a limited partnership to file a certificate detailing specified aspects of the partnership agreement.[7] The purpose of this requirement is to provide notice to the public of the limited liability assumed by the limited partners and of the relevant provisions of the partnership agreement. Brown v. Panish, 99 Cal. App. 3d 429, 160 Cal. Rptr. 282 (1979). California Code section 15502(2) provides that a limited partnership is formed if there has been substantial compliance in good faith with the statute. Cal. Code sec. 15502(2) (West 1984 Supp.). The facts indicate that the required certificate was not filed by the partnership until September 16, 1976. In a recent opinion, the Ninth Circuit held that substantial compliance requires more than a mere oral agreement. Mason v. Unkeless, 618 F.2d 597 (9th Cir. 1980).

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[7] Cal. Corp. Code sec. 15502 was repealed in 1981 and new sec. 15521 was added effective January 1, 1984. Sec. 15521 does not differ materially from former sec. 15502.

The GNMA commitment to purchase the loan was not obtained until July 20, 1976. As respondent points out, it is not possible to have a written loan commitment requiring the payment of these fees prior to the date on which the commitment was actually secured. Petitioners, however, argue that the existence of a written loan commitment on September 16, 1975, should be viewed in a broader perspective according to common business and lending practices. According to petitioners, the date of the conditional commitment from HUD (April 9, 1975) was the time by which all the parties had agreed that the project was feasible. Petitioners' reasoning, however, is incompatible with the statutory language set forth by Congress in the Tax Reform Act of 1976.

The transitional language setting forth the effective date of section 461(g)(1) focuses on the existence, as of September 16, 1975, of either a binding contract or a written loan commitment. In either case, the appropriate focus is on the documented contractual relationship between the lender and the borrower. The fact that Matsumoto, as promoter, expended funds on behalf of the partnership prior to September 16, 1975, is not determinative. In addition, the conditional commitment issued by HUD on April 9, 1975, served only as an indication of the Government's intention to issue a firm commitment if the borrower's application indicated that the project was being developed in a manner consistent with the specifications set forth in the conditional commitment.[8]

In Sandor v. Commissioner, 62 T.C. 469, 484 (1974), affd. 536 F.2d 874 (9th Cir. 1976), this Court held that the lender's general commitment to make a loan is not a binding obligation to prepay interest.

> We see no need to delve into the California law of contracts to determine whether the parties entered into a binding contract prior to November 26, 1968. It is enough to note that the California courts recognize that preliminary negotiations leading up to the execution of a contract do not constitute a binding contract. There must be a meeting of the minds on all the material terms of an agreement before it can ripen into a contract. Whether the parties were merely negotiating a contract

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[8] Robert Starr, former employee of Housing and Urban Development testified that the application for the conditional commitment would normally have had to be signed by the lender. This particular document, however, was not available for the Court's review.

> or entering into a binding contract is a question of intention. This is a question of fact to be determined by the Court from all the evidence. * * * [Citations omitted.][9]

According to the testimony of Michael Clancy, vice president of the United California Bank and originating loan officer for the Raintree Gardens project, the lender made no commitment, in writing or otherwise, prior to September 30, 1976, when the loan document itself was executed. In addition, Michael Clancy testified that the bank's practice was to delay seeking the approval of the loan committee until a firm commitment had been issued by HUD. This is because HUD potentially could refuse to insure the loan if some of the conditions were not fulfilled. Additionally, upon receipt of the firm commitment from HUD (January 29, 1976) the bank's loan committee still retained the authority to vote unfavorably on the partnership's loan application.

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[9] In Sandor v. Commissioner, 62 T.C. 469 (1974), affd. 536 F.2d 874 (9th Cir. 1976), this Court discussed the applicability of Rev. Rul. 68-643, 1968-2 C.B. 76, to prepaid interest prior to the passage of the Tax Reform Act of 1976. See Anderson v. Commissioner, 568 F.2d 386 (5th Cir. 1978), affg. a Memorandum Opinion of this Court; Cole v. Commissioner, 64 T.C. 1091 (1975), affd. 586 F.2d 747 (9th Cir. 1978). Rev. Rul. 68-643 was premised upon the Commissioner's authority under sec. 446(b) to reject a taxpayer's method of accounting if it did not clearly reflect income. The ruling states that the Commissioner would consider any prepayment of interest for a period extending beyond the end of the current taxable year as materially distorting income. Rev. Rul. 68-643 was made applicable to a legal obligation incurred after November 26, 1968.

During August of 1976 the commitments from HUD and GNMA were transferred by Molton, Allen to United California Mortgage Company, a division of United California Bank. Michael Clancy testified that as of August of 1976 when United California Mortgage Company became mortgagee of record, the decision of United California Bank to issue the loan remained contingent upon a favorable credit history with regard to Matsumoto. Michael Clancy further indicated that he had no personal authority to commit the bank to the loan prior to obtaining approval from the loan committee. According to this testimony there was no loan commitment, written or otherwise, issued by the lender prior to September 30, 1976, when the bank entered into a formal loan agreement with the partnership.

Petitioners recognize that the lender was not legally obligated to make the loan until the loan agreement was signed on September 30, 1976. Petitioners argue, however, that according to standard business and banking practices both the lender and the borrower presume that a loan will ultimately result once the conditional commitment is issued by HUD. Despite petitioners' assertion, however, the evidence clearly indicates that prior to September 16, 1975, there was no legal obligation on the part of United California Bank to issue the loan. We agree with respondent that the statutory language at issue was intended to provide taxpayers, the Commissioner, and the courts with a benchmark to avoid a circuitous inquiry into the subjective notions of business custom and banking policy.

The selection of the effective date for new legislation is by its nature often arbitrary. Such a selection often results in a seemingly harsh application of a sound legislative mandate. If Congress had wished to focus on an earlier stage in the lending process it would have done so. We can presume that the transitional language addressing prepaid interest paid pursuant to a written loan commitment existing on September 16, 1975, was drafted with an awareness that such language would be applied to transactions similar to the one before this Court. The conditional commitment issued by HUD indicates only that if the project develops in an acceptable manner, HUD will issue its firm commitment for mortgage insurance. The conditional commitment, however places no requirement on the lender and is unrelated to a commitment by the bank to make a loan requiring the prepayment of interest. Petitioners have failed to present evidence of the existence of either a binding contract or a written loan agreement on the dates in question. Therefore, the $60,327 in GNMA fees must be capitalized and amortized over the term of the loan in accordance with section 461(g)(1).

Decisions will be entered for the respondent.

742-B

Ju 11.7/2:1986-190

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ORIGINAL

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T. C. Memo. 1986-190

UNITED STATES TAX COURT

CYRUS KAVOOSI, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 34350-83. Filed May 12, 1986.

Using the bank deposits method, respondent determined that petitioner had unreported taxable income during the years in issue. The amount of income determined by respondent included substantial amounts of funds sent to petitioner from Iran. At trial, petitioner's motion to seal the record to protect the safety of the transferor of the funds was granted. Held: The amounts received by petitioner from Iran were gifts excludible from gross income under sec. 102(a), I.R.C. 1954. Held, further, Petitioner has established that he had no unreported taxable income for 1978. Held, further, Petitioner has failed to show that amounts in excess of funds received from Iran during 1977, 1979 and 1980 did not constitute taxable income. Held, further, Petitioner is liable for the addition to tax under sec. 6653(a) for 1977, 1979 and 1980. Held, further, The six year limitations period of sec. 6501(e)(1)(A) is inapplicable, and thus, the assessment and collection of tax for 1977 are barred by the statute of limitations. Sec. 6501(a).

Martin A. Schainbaum and Kathleen A. Miller, for the petitioner.

Gerald J. Beaudoin, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

FAY, Judge: Respondent determined the following deficiencies in and additions to petitioner's Federal income tax:

Year	Deficiency	Sec. 6653(a)[1] Addition to tax
1977	$89,841	$4,492
1978	38,750	1,938
1979	40,009	2,000
1980	10,149	507

After concessions, the issues are (1) whether petitioner received unreported taxable income during the years in issue in the amounts determined by respondent, (2) whether petitioner is liable for the addition to tax under section 6653(a) for each of the years in issue and (3) in the event we determine that petitioner received unreported taxable income for 1977 or 1978, whether the assessment and collection of tax for such years is barred by the statute of limitations.

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found.

Petitioner, Cyrus Kavoosi (herein, "petitioner"), resided in Capitola, Calif. when he filed his petition herein.

Petitioner was born in Iran in 1939. He left that country in 1963 and has resided since that time in the United States. From 1963 to the present, petitioner has worked at a variety of jobs in the restaurant industry, including bus boy, dish washer, waiter, bartender, bar manager and restaurant manager. During each of the years in issue, petitioner owned various rental properties. Furthermore, during 1979 and 1980, he participated in a joint venture involving a Chinese restaurant called "Chef Tong."

In December 1976, petitioner's parents came to reside permanently in the United States. At that time, petitioner's mother was suffering from a heart condition.

Petitioner uses the calendar year as his taxable year and filed Federal income tax returns for each of the years in issue. His return for 1977 was filed on or about May 22, 1978. Therein, he reported wages of $3,900, interest income of $2,136, gross rental income of $22,380 and, after deductions for depreciation and expenses with respect to rental property, a net rental loss of $2,738.67. Petitioner reported taxable income of $3,297.33 and indicated his Federal income tax liability for 1977 to be $11.00.

Petitioner timely filed his Federal income tax return for 1978 on or about October 15, 1979. For that year, he reported wages of $11,050, interest income of $2,525, gross rental income of $37,200 and, after deductions for depreciation and relevant expenses, net rental income of $10,599. Petitioner reported taxable income of $16,449 and indicated liability for Federal income tax for 1978 in the amount of $2,878.

On or about October 15, 1980, petitioner timely filed his Federal income tax return for 1979. Therein, petitioner reported no wage income, but showed interest income of $3,341, gross rental income of $52,800 and, after deductions for depreciation and relevant expenses, net rental income of $27,508. Petitioner also reported as income $2,428, representing his share of income from the Chef Tong restaurant joint venture. He showed taxable income of $24,828 and Federal income tax liability of $4,487 for 1979.[2]

Petitioner filed his 1980 Federal income tax return on or about June 16, 1982. Therein, he showed no income from wages, but reported interest income in the amount of $5,774, gross rental income of $66,575 and, after deductions for depreciation and relevant expenses, net rental income of $13,333. In addition, petitioner showed a loss of $31,967 from the Chef Tong restaurant joint venture. Petitioner reported "other income," including proceeds of certain disability insurance, totaling

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[2] On this return, petitioner also showed liability for Federal self-employment tax in the amount of $197.00.

$24,600. In sum, petitioner reported taxable income of $2,527 and indicated that he had no Federal income tax liability for 1980.

During each of the years in issue, petitioner received various transfers of funds from Iran, as indicated by the following table:

Year	Total amount of funds received from Iran
1977	$137,200.00
1978	89,980.00
1979	54,280.50
1980	1,795.42

Petitioner maintained a savings account (No. 2-04077) at the Bank of America and a savings account (No. 5-227456-0) at World Savings and Loan Association during each of the years in issue. From 1978 through 1980, petitioner also maintained a checking account (No. 8-06433) at the Bank of America. During 1977 and 1978, petitioner made total deposits to these accounts of $181,495.62 and $123,442.89, respectively. In 1979 and 1980, petitioner's total deposits to these accounts were $120,228.28 and $301,719.88, respectively.[3] The funds transferred from Iran

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[3] The following table reflects an account-by-account summary of petitioner's total bank deposits during the years in issue:

Year	World Savings Account	Bank of America Savings Account	Bank of America Checking Account	Total
1977	$148,695.62	$ 32,800.00	—	$181,495.62
1978	18,412.89	89,980.00	15,050.00	123,442.89
1979	22,403.36	57,204.92	40,620.00	120,228.28
1980	2,343.80	125,602.08	173,774.00	301,719.88

were deposited to petitioner's bank accounts during the years in issue and thus, are included among these deposits.[4] On September 14, 1983, respondent issued a notice of deficiency in which he determined that certain of petitioner's bank deposits, including the funds from Iran, constituted unreported taxable income during the years in issue, as reflected by the following table:

Year	Total Amount of Bank deposits	Amount of deposits determined by respondent to constitute unreported taxable income
1977	$181,495.62	$151,006
1978	123,442.89	64,668
1979	120,228.28	58,911
1980	301,719.88	34,094

Respondent has conceded that an additional $4,217.97 of the deposits made during 1980 is attributable to non-taxable sources. He thus asserts herein that, during 1980, petitioner received unreported taxable income of $29,876.03, rather than $34,094.

OPINION

The first issue is whether petitioner received unreported taxable income during the years in issue in the amounts determined by respondent.

Respondent's determination is based upon deposits made to petitioner's bank accounts during the years in issue. The use of the bank deposits method of computing income has long been sanctioned by the courts as a method of reconstructing income. See, e.g., *Goe v. Commissioner*, 198 F.2d 851 (3d Cir. 1952), affg. a Memorandum Opinion of this Court, cert. denied 344 U.S. 897 (1952); *Halle v. Commissioner*, 175 F.2d 500 (2d Cir. 1949), affg. 7 T.C. 245 (1946), cert. denied 388 U.S. 949 (1950); *Mauch v. Commissioner*, 113 F.2d 555 (3d Cir. 1940), affg. 35 B.T.A. 617 (1937); *Oliver v. United States*, 54 F.2d 48 (7th Cir. 1931), cert. denied 285 U.S. 543 (1932). Respondent's deficiency determination is presumptively correct and petitioner has the burden of proving otherwise. Rule 142(a); *Welch v. Helvering*, 290 U.S. 111 (1933). A deficiency determination based on the bank deposits method of reconstructing income is entitled to such presumption, and petitioner bears the burden of proving that such determination is incorrect. *Armes v. Commissioner*, 448 F.2d 972 (5th Cir. 1971), revg. on other issues a Memorandum Opinion of this Court; *Estate of Mason v. Commissioner*, 64 T.C. 651, 656-657 (1975), affd. 566 F.2d 2 (6th Cir. 1977); *Jones v. Commissioner*, 29 T.C. 601 (1957).

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[4] While the record is not entirely clear, the parties are apparently in accord on this point. Respondent on brief states that "all of the transferred sums ended up in petitioner's bank accounts."

Petitioner does not contend that respondent's use of the bank deposits method to determine his taxable income for the years in issue was improper. Rather, the essence of his position lies in the fact that the amounts determined by respondent to constitute unreported taxable income include funds received by petitioner from Iran. Petitioner contends that the funds received from Iran were gifts and, as such, were excludible from gross income. Respondent recognizes that the amount of unreported taxable income determined by him includes the funds received by petitioner from Iran, but he asserts that such funds were not gifts. Resolution of this issue thus requires a determination of whether the funds transferred from Iran were gifts to petitioner.

Section 61(a) provides generally that gross income includes all income from whatever source derived. However, an exception to this rule is contained in section 102(a), which provides that gross income does not include the value of property acquired by gift. Whether an item constitutes gross income under section 61(a) or a gift under section 102(a) is essentially a question of fact to be resolved by the trier of the facts. The Supreme Court has stated that a gift, in the statutory sense, "proceeds from a 'detached and disinterested generosity,' * * * 'out of affection, charity or like impulses'." *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960). In this regard, the most critical consideration is the intention of the transferor in making the payment. The issue is primarily one of fact, and its resolution "must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case." See *Commissioner v. Duberstein*, *supra* at 285-286, 289. After considering the record before us, we are persuaded that the amounts received by petitioner from Iran were indeed gifts.

Petitioner testified that the funds from Iran had been sent to him by a wealthy individual in that country (herein, referred to as "X").[5] He indicated that X had much affection for him and wanted him to have funds to support himself and care for his parents, both of whom had recently arrived in this country, and one of whom was in ill health. Petitioner testified that he used the funds to help support his parents and other members of his family living in the United States. He testified that X did not expect any repayment of the funds. He stated that there was no understanding that interest would be paid on the transferred funds and, in fact, none was paid. Petitioner further testified that these funds did not represent compensation for services, nor were they attributable to any business interest held by him. Petitioner consistently maintained that the funds were a gift.

Although X was in Iran and thus unavailable to testify at the time of trial, X's deposition was taken prior to trial by order of the Court pursuant to Rule 81(a). Counsel for respondent was present at the taking of such deposition, and availed himself of the opportunity to cross-examine X. The deposition was introduced into the record as an exhibit to the stipulation of facts.

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[5] Petitioner has expressed concern that the safety of the transferor of the funds, currently residing in Iran, might be compromised by reason of involvement in the matters relating to this proceeding. Accordingly, upon petitioner's motion, the Court issued an order on July 31, 1985 whereby the entire trial record in this case was placed under seal. In keeping with the objectives of that order, we refer herein to the individual in question as "X". Similarly, we limit our discussion of facts relating to X and the transfers in issue to those necessary to our decision herein.

X's testimony on deposition supports the testimony given by petitioner at trial. The substance of X's testimony was that: (1) X is a well-educated individual who possesses substantial wealth; (2) X felt a great deal of affection for petitioner, was aware of his personal and family situation, and accordingly, sent him the funds in question to support himself and to care for his parents; (3) there was no understanding that petitioner would repay the transferred funds, pay interest thereon, or use such funds to purchase properties or otherwise transact business on behalf of X; and (4) the funds were not sent to petitioner as compensation or in connection with any business interest held by petitioner, but rather were intended simply as a gift.

On brief, respondent attempts to discredit the testimony of both X and petitioner. He attaches significance to the fact that X could not recall the precise amounts sent to petitioner during the years in issue. However, X testified on deposition that, since the amounts transfered to petitioner were small in relation to X's net worth and were intended as outright transfers of funds with no expectation of repayment, X was not concerned with keeping a detailed account of the specific amounts. X also indicated that it was difficult to recall specific amounts for the years in question due to differences between the United States and Iranian calendars. In addition, it is reasonable to think that exactitude in determining amounts is further complicated where, as appears to be the case herein, the amounts in question involve the conversion of funds from foreign to United States currency. X's lack of precision concerning the amounts sent to petitioner is understandable in view of the circumstances here present, and we thus find no merit in respondent's efforts to discredit X's testimony. Similarly, we are unpersuaded by respondent's attempts to cast doubt upon petitioner's credibility. We had the opportunity to closely observe petitioner's demeanor at trial and found him to be a forthright and credible witness. Thus, we accept and accord proper weight to petitioner's testimony.

While respondent does not dispute that the transfers of funds in question originated in Iran, he emphasizes the failure of petitioner to present documentary evidence, particularly bank records, to establish that X was the person who sent such funds.[6] It is true, as respondent points out on brief, that "the failure of a party to introduce evidence within his possession which, if true, would be favorable to him, gives rise to the presumption that if produced it would be unfavorable." Wichita Terminal Elevator Co. v. Commissioner, 6 T.C. 1158, 1165 (1946), affd. 162 F.2d 513 (10th Cir. 1947). From the record, however, we do not consider this principle to be applicable herein, since it does not appear that the bank records which respondent would have petitioner introduce are in petitioner's possession or are in any meaningful sense available to him. First, it is questionable whether any such records are presently in existence. X's testimony indicated that, in the wake of political and social unrest occurring at the time of the Iranian revolution in 1979, a number of banks were destroyed together with their records. Moreover, X also testified that, with the entrenchment of the Khomeini regime, the sending of funds from Iran, especially to the United States, became increasingly difficult and was met with disfavor by the Iranian government. Accordingly X testified to having disposed of all personal copies of relevant bank records for fear of possible reprisals. Lastly, both petitioner and X testified that, since the transfers of funds were disapproved of by the Iranian authorities, current inquiries concerning any existing records might arouse suspicion and subject X to reprisals at the hands of the Iranian government. We are well aware and take judicial notice of the political events occurring in Iran both during the years in issue and presently. In view thereof, we consider the testimony of petitioner and X on this matter to be credible, and we conclude that the absence of documentary evidence herein in the form of bank records showing that X made the transfers in question is adequately explained.

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[6] We note that petitioner has produced and the parties have stipulated to copies of bank documents which reflect petitioner's receipt of funds from Iran. As a general matter, however, such documents do not reflect the identity of the party sending the funds.

Thus, the fact that petitioner did not introduce such evidence is not, under the particular circumstances here present, fatal to his case.

Based upon the evidence in the record, particularly the testimony of petitioner and the deposition of X, we conclude that the funds received by petitioner from Iran were sent by X.[7] Further, we find that the transfers of such amounts were attributable to X's "detached and disinterested generosity" and were motivated by "affection, charity or like impulses." Commissioner v. Duberstein, supra. Accordingly, we hold that the amounts received by petitioner from Iran during the years in issue were gifts, and are therefore excludible from gross income by reason of section 102(a).

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[7] As noted, the taking of X's deposition was authorized by an order of the Court pursuant to Rule 81(a). Rule 81(i), which governs the use of depositions, provides as follows:

> At the trial or in any other proceeding in the case, any part or all of a deposition, so far as admissible under the rules of evidence applied as though the witness were then present and testifying, may be used against any party who was present or represented at the taking of the deposition or who had reasonable notice thereof, in accordance with any of the following provisions:
>
> * * *
>
> (3) The deposition may be used for any purpose if the Court finds: * * * (B) that the witness is at such distance from the place of trial that it is not practicable for him to attend, unless it appears that the absence of the witness was procured by the party seeking to use the deposition; or * * * (E) that such exceptional circumstances exist, in regard to the absence of the witness at the trial, as to make it desirable in the interests of justice, to allow the deposition to be used.

Counsel for respondent was present at the taking of X's deposition. Since X was in Iran at the time of the trial, and X's absence at trial was not procured by petitioner, we consider use of the deposition to establish that X sent funds to petitioner as gifts to be authorized under subparagraph (3)(B) of Rule 81(i). Cf. Foster v. Commissioner, 80 T.C. 34, 132-133 (1983), affd. in part, vacated in part 756 F.2d 1430 (9th Cir. 1985). Alternatively, we think that, in this case, as provided in subparagraph (3)(E) of Rule 81(i), such exceptional circumstances exist with regard to X's absence at trial to make it desirable in the interests of justice to allow the deposition to be used for this purpose.

Having decided that the amounts received by petitioner from Iran during the years in issue are excludible from gross income as gifts, we now apply our conclusion to the facts of this case. As the following table indicates, there are discrepancies between the amount of unreported taxable income determined by respondent, and the amount of funds received by petitioner from Iran during the years in issue.

	1977	1978	1979	1980
Unreported income as determined by respondent	$151,006	$64,668	$58,911.00	$29,876.03[8]
Less: Amount received by petitioner from Iran	137,200	89,980	54,280.50	1,795.42
Difference:	13,806	(25,312)[9]	4,630.50	28,080.61

As to 1978, petitioner has established that the amount which respondent determined to be unreported income is more than accounted for in its entirety by funds from Iran. Consequently, we find that petitioner has satisfied his burden of proving that he had no unreported taxable income for 1978. As to 1977, 1979 and 1980, however, petitioner has failed to identify or account for the respective amounts of $13,806, $4,630.50 and $28,080.61. Petitioner has offered no explanation nor has he introduced any evidence to show that these amounts do not constitute taxable income. As to such amounts, petitioner has failed to satisfy his burden of proof, and thus, respondent's determination must be sustained to this extent.

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[8] This figure reflects respondent's concession, referred to, supra, that an additional $4,217.97 of petitioner's 1980 deposits is attributable to non-taxable sources.

[9] The reason for this discrepency is not clear from the record, and the parties have not illuminated us with regard thereto. It would indicate that, for 1978, respondent determined that an amount less than the full amount of funds received from Iran constituted taxable income.

The second issue is whether petitioner is liable for the addition to tax under section 6653(a) for any of the years in issue. That section provides for an addition to tax in an amount equal to 5 percent of the underpayment if any part thereof is due to negligence or intentional disregard of rules and regulations. Petitioner bears the burden of proof with respect to this issue. Enoch v. Commissioner, 57 T.C. 781, 802 (1972).

We have determined that petitioner had no unreported income for 1978. For that year, there is thus no deficiency and no underpayment. See sec. 6653(c)(1).[10] Since imposition of the addition to tax under section 6653(a) requires the existence of an underpayment, we conclude that petitioner is not liable for this addition to tax with respect to 1978. As regards 1977, 1979 and 1980, we have held, supra, that petitioner has failed to establish that he did not have unreported taxable income in the respective amounts of $13,806, $4,630.50 and $28,080.61. Since these amounts give rise to underpayments of tax for such years within the meaning of section 6653(c)(1), it was incumbent upon petitioner to show that such underpayments were not attributable to negligence or intentional disregard of rules and regulations. Petitioner has failed to introduce evidence and has thus failed to satisfy his burden of proof on this issue. Accordingly, we hold that petitioner is liable for the addition to tax under section 6653(a) with respect to 1977, 1979 and 1980.

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[10] For purposes of the addition to tax under sec. 6653(a), where a return is timely filed, the term underpayment means a deficiency. See sec. 6653(c)(1). Petitioner's Federal income tax return for 1978 was timely filed. Since we have held that there is no deficiency for 1978, we similarly conclude there is no underpayment for that year within the meaning of section 6653(a).

Since we have held that there is a deficiency and an addition to tax under section 6653(a) applicable with respect to 1977, we now consider the final issue of whether the assessment and collection of tax for that year are barred by the statute of limitations.[11]

In general, the assessment of tax must be made within three years after the filing of a return. Sec. 6501(a). However, a specific exception to this rule is set forth in section 6501(e)(1)(A). Under that provision, if the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the applicable limitations period is six years from the filing of the return. See sec. 6501(e)(1)(A). The mailing of a statutory notice of deficiency and the filing of a petition in this Court have the effect of suspending the running of the statute of limitations until this Court's decision becomes final, and for an additional sixty days thereafter. See secs. 6503(a)(1), 6213(a). Thus, we must determine whether respondent's notice of deficiency was issued prior to the expiration of the limitations period.

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[11] We need not consider this issue as it relates to 1978, since, as we have held, supra, there is no deficiency and no addition to tax applicable with respect to that year. With respect to 1979 and 1980, the parties agree that the assessment and collection of tax are not barred by the statute of limitations.

Petitioner filed his 1977 Federal income tax return on or about May 22, 1978, and respondent issued his notice of deficiency on September 14, 1983. Petitioner asserts that the assessment and collection of tax for 1977 are barred by section 6501(a) because the notice of deficiency was issued more than three years after the filing of petitioner's Federal income tax return for that year. Respondent acknowledges that, with regard to 1977, the notice of deficiency was not issued within the three year period specified in section 6501(a). He contends, however, that the assessment and collection of tax for 1977 are permitted by reason of the six year limitations period set forth in section 6501(e)(1)(A).

Respondent bears the burden of proving that the six year statute of limitations provided for in section 6501(e)(1)(A) is applicable. Thereunder, he must show (1) that petitioner omitted from gross income an amount in excess of 25 percent of the amount of gross income stated in the return and (2) that the omitted amount was properly includible in gross income. See Bardwell v. Commissioner, 38 T.C. 84 (1962), affd. 318 F.2d 786 (10th Cir. 1963); Seltzer v. Commissioner, 21 T.C. 398 (1953); Reis v. Commissioner, 1 T.C. 9 (1942), affd. 142 F.2d 900 (6th Cir. 1944). Respondent may meet this burden of proof only by affirmative evidence; the presumption of correctness which generally attaches to respondent's deficiency determinations may not be relied upon in this regard. See Reis v. Commissioner, supra.

In his Federal income tax return for 1977, petitioner reported gross income of $28,416.[12] Respondent determined that certain of petitioner's bank deposits during that year, amounting to $151,006, constituted unreported taxable income. We have held that, of this amount, $137,200 constituted non-taxable gifts from Iran. Thus, we are left with the fact that petitioner had unexplained bank deposits for 1977 in the amount of $13,806.00. This amount is clearly more than 25 percent of $28,416, the amount of gross income stated in petitioner's 1977 return. However, respondent has failed to show, as he must to prevail on this issue, that the omitted amount was properly includible in gross income. The mere existence of bank deposits, although not explained or accounted for, does not of itself show that the sums were or were not income. Just as petitioner has failed to prove that the bank deposits in excess of the amounts transferred from Iran were not income, respondent has similarly failed to prove that the amounts in question were income. The mere showing on respondent's part that there was a failure to report as income items which, insofar as the evidence shows, might or might not have been income does not satisfy his burden of proving that petitioners omitted from gross income stated in their return an amount properly includible therein. Cf. Jones v. Commissioner, 29 T.C. 601, 619 (1957).[13]

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[12] This amount consists of wages in the amount of $3,900, interest in the amount of $2,136 and gross rental income in the amount of $22,380.

By reason of respondent's failure to bear his burden of proof, the statute of limitations issue for 1977 is decided for petitioner.

To reflect concessions and the foregoing,

Decision will be entered
under Rule 155.

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[13] See also Macri Corporation v. Commissioner, T.C. Memo. 1976-273 and cases cited therein.

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COMPLETED

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MF 156

T. C. Memo. 1986-191

UNITED STATES TAX COURT

MILDRED R. FICCHI, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

JOSEPH R. AND ELIZABETH A. FICCHI, Petitioners, v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 27109-84, 31182-84. Filed May 12, 1986.

William G. Rosing, for the petitioner in docket No. 27109-84.

Brian S. Grach and Robert J. Masini, for the petitioners in docket No. 31182-84.

Michael J. Calabrese, for the respondent.

MEMORANDUM OPINION

VANDERVORT, Special Trial Judge: These cases were heard pursuant to the provisions of section 7456 and Rule 180.[1] In these consolidated cases respondent determined the following deficiencies:

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise stated. All Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise indicated.

Docket No.	Petitioner	Year	Deficiency
27109-84	Mildred R. Ficchi	1981	$1,245.00
31182-84	Joseph R. Ficchi and Elizabeth A. Ficchi[2]	1981	1,889.00

The issues for our decision are (1) whether payments made under a temporary order by petitioner - Joseph R. Ficchi to petitioner - Mildred R. Ficchi were payments made for the latter's support or maintenance and thus includable in Mildred R. Ficchi's gross income under section 71 and deductible by Joseph R. Ficchi pursuant to section 215; and, (2) whether the payment of 50% of petitioner - Joseph R. Ficchi's military pension to Mildred R. Ficchi pursuant to the dissolution of their marriage is a property settlement or alimony, the latter being includible in Mildred R. Ficchi's gross income under section 71.

These cases were submitted under Rule 122. All facts have been stipulated. The stipulation of facts and attached exhibits are incorporated herein by this reference.

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[2] Elizabeth A. Ficchi is a petitioner in this case solely by virtue of having filed jointly with Joseph R. Ficchi for the year in question.

Petitioners Joseph R. Ficchi (Joseph) and Elizabeth A. Ficchi and petitioner Mildred R. Ficchi (Mildred) were residents of Lake County, Illinois at the time they filed the petitions in their respective cases.

Joseph began employment as an active duty serviceman in the Navy in 1948. On February 14, 1953 Joseph and Mildred were married. Joseph eventually retired from active duty in the Navy in 1970. In December of 1979, after 26 years of marriage, Mildred and Joseph parted and began maintaining separate households.

Joseph filed for divorce on January 8, 1980, in the Circuit Court for the Nineteenth Judicial Circuit, Lake County, Illinois. On April 9, 1980 the Court entered the following order (the temporary order):

> 1. That the Petitioner [Joseph] pay to the Respondent [Mildred] the sum of $325.00 per month towards the household expenses. Said sum to be payable $100.00 by April 18, 1980 and $225.00 by April 30 and $325.00 per month thereafter until further order of court.
>
> 2. That the Petitioner [Joseph] shall pay the remaining trailer payments, the Sears and Visa payments; the insurance due on his and her car, but the insurance on the wife's car is to be paid only for a three month period.

The following year, on January 21, 1981, Mildred counter-petitioned the court for legal separation. In her counter-petition Mildred sought, inter alia, maintenance for herself and a judgment of legal separation. This counter-petition was subsequently dismissed on May 6, 1981. Shortly thereafter, on June 15, 1981, the court entered a Judgment for Dissolution of Marriage (Judgment) which provided in pertinent part:

> THE COURT DOTH FIND:
>
> 1. That this Court has jurisdiction of the parties and the subject matter herein; that it has considered, approved, and/or made provisions for the maintenance of either spouse and the disposition of the property.
>
> * * *
>
> 6. That the parties hereto have entered into an oral property settlement agreement, settling and disposing of all matters of the division of the marital and non-marital property, maintenance of either spouse and all other matters pertaining hereto. That said oral agreement as hereinafter set forth is made a part of this Judgment:
>
> A. Respondent is to receive ONE-HALF (1/2) of the Petitioner's government retirement check each month. This is to remain for life regardless of the fact whether she remarries or not. The Petitioner shall arrange to have said payments made directly to the Respondent from the pay center in Cleveland, Ohio. The government retirement check shall be the gross check minus only the taxes due on said amount.
>
> B. That the Respondent may avail herself of any legislation in the future which may alter, change or in any way involve her status insofar as her being entitled to the share of pension to be paid to her and may avail herself of any Federal benefits to which she may be or may later become entitled.
>
> C. The Petitioner is to pay unto the Respondent past due monies owed to her, namely: May, 1980, the sum of THREE HUNDRED TWENTY-FIVE AND NO/100's ($325.00) DOLLARS: December, 1980, the sum of ONE HUNDRED AND NO/100's ($100.00) DOLLARS; January, 1981, ONE HUNDRED AND NO/100's ($100.00) DOLLARS; and insurance in the sum of FIVE HUNDRED FIFTY AND NO/100's ($550.00) DOLLS [sic], for a total of ONE THOUSAND SEVENTY-FIVE AND NO/100's ($1,075.00) DOLLARS.
>
> D. The Respondent is to receive as her sole

and separate property, free and clear of any claims of the Petitioner, the 1970 Sterling trailer and all of its contents.

E. The Respondent is to receive as her sole and separate property, free and clear of any claims of the Petitioner the 1977 Buick automobile, which is presently in her possession.

F. Except as hereinabove provided, each party shall retain such marital and non-marital assets as now in their respective possessions free and clear of any claims, one to the other.

G. Except as hereinabove provided, each party [shall] waive any and all claims to maintenance, one from the other, past, present and future.

* * *

IT IS, THEREFORE, ORDERED AND ADJUDGED as follows:

* * *

B. That the property settlement agreement hereinabove referred to in Paragraph 6, subparagraphs A through J, both inclusive, be and the same are hereby confirmed and merged in this Judgment, and the duties and obligations of the parties thereunder are made enforceable hereby.

* * *

Sometime after the Judgment and before the close of 1981, Joseph was married to Elizabeth A. Ficchi.

During 1981 Mildred received the following payments pursuant to the temporary order.

Date of Check	Amount of Check
1-30-81	$ 325
2-28-81	325
3-30-81	300
4-29-81	325

5-12-81	175
5-29-81	385
6-11-81	900
	$2,735

In the second half of 1981 Mildred received the following payments from Joseph pursuant to the Judgment. These payments, which constituted one-half of Joseph's military pension, were awarded to Mildred in paragraph 6.A of the Judgment.

Date of Check	Amount of Check
6-30-81	$ 385
7-30-81	385
9-3-81	385
10-9-81	385
10-30-81	385
12-1-81	385
	$2,310

Therefore, Joseph made payments totaling $5,045 to Mildred in 1981 ($2,735 under the temporary order plus $2,310 of pension benefits pursuant to the Judgment).

On his 1981 Federal income tax return Joseph treated these payments as alimony and deducted them pursuant to section 215. In addition he erroneously deducted a $385 pension payment made to Mildred in 1982, so that his total alimony deduction for 1981 was $5,430. Mildred included neither the payments made under the temporary order nor the pension payments made pursuant to the Judgment on her Federal income tax return for 1981.

Respondent issued separate notices of deficiency to Joseph and Mildred on July 8, 1984. Joseph's notice reflected a deficiency of $1,889. Respondent based the deficiency upon the determination that the amounts paid to Mildred were not alimony under section 71(a) and, therefore, not deductible under section 215. Mildred's notice reflected a deficiency of $1,245 and was based on respondent's position that the amounts received from Joseph were alimony under section 71(a) and, therefore, includible in gross income.

Petitioner Joseph argues that the payments made under the temporary order and the pension payments made under the Judgment are alimony payments paid for Mildred's support and maintenance. Petitioner Mildred argues that the payments made under the temporary order are not alimony because they were advanced to her in order to pay off joint credit obligations of the couple. Further, Mildred contends that the pension payments are not alimony but are part of a property settlement.

The first issue we must resolve is whether payments (in the amount of $2,735) made under the temporary order were for Mildred's support and maintenance and therefore includible in her 1981 gross income pursuant to section 71(a). Our resolution of this issue will dictate the answer to the collateral issue of whether Joseph may deduct the $2,735 paid in 1981 under section 215.

Under section 71(a), the former spouse's gross income includes periodic payments received from the taxpayer:

> (1) under a decree of divorce or separate maintenance,
>
> (2) under a written separation agreement, or
>
> (3) under a decree for support.[3]

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[3] SEC. 71. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS.

(a) GENERAL RULE.--

(1) DECREE OF DIVORCE OR SEPARATE MAINTENANCE.--If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

(2) WRITTEN SEPARATION AGREEMENT.--If a wife is separated from her husband and there is a written separation agreement executed after the date of the enactment of this title, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such agreement is executed which are made under such agreement and because of the marital or family relationship (or which are attributable to property transferred, in trust or otherwise, under such agreement and because of such relationship). This paragraph shall not apply if the husband and wife make a single return jointly.

(3) DECREE FOR SUPPORT.--If a wife is separated from her husband, the wife's gross income includes periodic payments (whether or not made at regular intervals) received by her after the date of the enactment of this title from her husband under a

(footnote continued)

Section 215 provides a deduction for amounts paid by a taxpayer to a former spouse if the former spouse is required to include these amounts in gross income under section 71(a).[4]

Under section 71(a)(3), periodic support payments received by the wife from her husband pursuant to a court decree while they are separated are taxable as income. Furgatch v. Commissioner, 74 T.C. 1205, 1209 (1980). The Congressional purpose behind this subsection is to embrace in gross income all support payments made pursuant to judicial sanction where spouses are in fact living apart. Knobler v. Commissioner, 59 T.C. 261, 263 (1972). See also section 1.71-1(b)(3), Income Tax Regs.

At the time Joseph made the payments under the temporary order, the petitioners were living apart. These payments were periodic in nature, occurring approximately once a month for six months in 1981. Joseph made these payments pursuant to an order

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decree entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance. This paragraph shall not apply if the husband and wife make a single return jointly.

[4] SEC. 215. ALIMONY, ETC., PAYMENTS.

(a) GENERAL RULE.--In the case of a husband described in section 71, there shall be allowed as a deduction amounts includible under section 71 in the gross income of his wife, payment of which is made within the husband's taxable year. No deduction shall be allowed under the preceding sentence with respect to any payment if, by reason of section 71(d) or 682, the amount thereof is not includible in the husband's gross income.

of the Circuit Court for the Nineteenth Judicial Circuit, Lake County, Illinois, which designated the payments to be used for the satisfaction of the household expenses of Mildred. Additional sums were required pursuant to the second paragraph of the temporary order to cover credit card payments, trailer payments and insurance payments.

We believe that the payments from Joseph to Mildred for the satisfaction of household expenses were periodic payments made for Mildred's support or maintenance pursuant to a court decree. They were not shown to be payments to satisfy joint credit obligations of the couple as Mildred contends. Such credit obligations were specifically noted and separately provided for in the second paragraph of the temporary order. The first paragraph of the order recites that the sum of $325 per month is to be paid for household expenses. Because of this delineation, we conclude that the payments in question were made for Mildred's support and maintenance. As such, these payments are includible in Mildred's gross income under section 71(a)(3).

Because we have determined that the $2,735 in payments made under the temporary order are includible in Mildred's gross income under section 71(a), it follows that Joseph may deduct an equal amount under section 215.[5]

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[5] No explanation was given as to why two payments were less than the required $325 per month, or why one payment was well in excess of $325. Therefore, we must assume that all the payments made from January 30, 1981 to June 11, 1981 were for Mildred's support and maintenance. The total of these payments is $2,735.

The second issue we must decide is whether the payments to Mildred of 50% of the military pension are periodic payments made in discharge of a legal obligation incurred because of the marital relationship or whether they result from a property settlement made pursuant to the dissolution of Joseph and Mildred's marriage. Again, our resolution of this issue will dictate the tax treatment of these payments for both Mildred and Joseph under sections 71(a) and 215. If we determine that the payments are alimony, they will be deductible by Joseph and taxable to Mildred. If, on the other hand, the division of the military pension is a property settlement, then there will be no such tax effect to either petitioner.[6]

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[6] See, e.g., Schottenstein v. Commissioner, 75 T.C. 451, 456 (1980), where this Court stated: "If the payments required under * * * the separation agreement effected a property division or satisfied [the wife's] property rights, they would neither be includible in her gross income under section 71(a) nor deductible by [the husband] under section 215, since they would be capital in nature." (Emphasis added.)

In the notice of deficiency issued to Mildred the Commissioner determined that the payments from the military pension are alimony and must be included in income under section 71(a). In the notice of deficiency issued to Joseph, the Commissioner took a contrary position stating that the pension payments made to Mildred are not alimony and are therefore not deductible under section 215. In addition, the notice stated that lump sum cash or private settlements are similarly not deductible.

Respondent argued for the first time on brief that if the payments to Mildred did constitute a distribution of marital property that such payments would be taxable to her as a pension pursuant to section 61(a)(11). This theory is not found in either notice of deficiency, respondent's answer, nor is there any indication in the Stipulation of Facts or attached exhibits

(footnote continued)

The determination of whether payments are in the nature of alimony or are part of a property settlement does not turn on the labels given to the payments by a court in the divorce decree or by the parties in their agreement. *Hesse v. Commissioner*, 60 T.C. 685, 691 (1973), affd. without published opinion 511 F.2d 1393 (3d Cir. 1975), cert. denied 423 U.S. 834 (1975); *Thompson v. Commissioner*, 50 T.C. 522, 525 (1968). The resolution of the issue requires an examination of all the surrounding facts and circumstances. *Wright v. Commissioner*, 62 T.C. 377, 389 (1974), affd. 543 F.2d 593 (7th Cir. 1976); *Hesse v. Commissioner*, *supra*.

Factors which indicate whether the payments are in the nature of a property settlement rather than a support allowance have been enumerated in *Beard v. Commissioner*, 77 T.C. 1275, 1284-1285 (1981). Nevertheless, since we are dealing with a state court division of rights upon dissolution of marriage, we recognize that the property interests of Joseph and Mildred are determined under the laws of the State of Illinois. *Schottenstein v. Commissioner*, 75 T.C. 451, 462 (1980); *Estate of*

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that such an argument would be advanced.

This Court has consistently refused to consider issues first raised on brief when surprise and prejudice are found to exist. *Robertson v. Commissioner*, 55 T.C. 862, 865 (1971); *Philbrick v. Commissioner*, 27 T.C. 346, 353 (1956). We believe that petitioner Mildred is unfairly prejudiced and is unable to adequately respond to an argument advanced after the submission of the case under Rule 122. We will simply not allow respondent to assert new issues into a case in the eleventh hour. Accordingly, we will not decide the merits of respondent's untimely contention at this time. Thus, respondent's argument shall be reserved for another day.

Gamble v. Commissioner, 69 T.C. 942, 948 (1978). After determining what property interests are conferred upon Mildred and Joseph by state law, the tax treatment of this interest is governed by Federal tax law. Estate of Gamble, supra; Estate of Lanigan v. Commissioner, 45 T.C. 247 (1965).

We begin our inquiry with an analysis of the statutory and judicial authority governing the division of property and the award of alimony in Illinois. The divorce of Joseph and Mildred is governed by the Illinois Marriage and Dissolution of Marriage Act (Marriage Act) which became effective in 1977. Ill. Rev. Stat. ch. 40, section 101 et seq. (Smith-Hurd 1980). The passage of the Marriage Act introduced equitable distribution to Illinois.

In determining a division of property pursuant to a divorce, the court is directed to distinguish between "marital" and "non-marital" property, dividing only the former between the spouses. Ill. Rev. Stat. ch. 40, section 503 (Smith-Hurd 1980). Section 503 of the Marriage Act states the following in pertinent part:

> (a) For purposes of this Act, "marital property" means all property acquired by either spouse subsequent to the marriage, except the following, which is known as "non-marital property":
>
> (1) property acquired by gift, bequest, devise or descent;
>
> (2) property acquired in exchange for property acquired before the marriage or in exchange for property acquired by gift, bequest, devise or descent;

(3) property acquired by a spouse after a judgment of legal separation;

(4) property excluded by valid agreement of the parties;

(5) the increase in value of property acquired before the marriage; and

(6) property acquired before the marriage.

In addition "[a]ll property acquired by either spouse after the marriage and before judgment of dissolution of marriage * * * is presumed to be marital property * * *." Section 503(b), Marriage Act.

Once the court has determined which items are marital property and which items are non-marital property, the court will divide the marital property (without taking into account marital misconduct) in just proportions after considering all relevant factors including:

(1) the contribution or dissipation of each party in the acquisition, preservation, or depreciation or appreciation in value, of the marital and non-marital property, including the contribution of a spouse as a homemaker or to the family unit;

(2) the value of the property set apart to each spouse;

(3) the duration of the marriage;

(4) the relevant economic circumstances of each spouse when the division of property is to become effective, including the desirability of awarding the family home, or the right to live therein for reasonable periods, to the spouse having custody of the children;

> (5) any obligations and rights arising from a prior marriage of either party;
>
> (6) any antenupital agreement of the parties;
>
> (7) the age, health, station, occupation, amount and sources of income, vocational skills, employability, estate, liabilities, and needs of each of the parties;
>
> (8) the custodial provisions for any children;
>
> (9) whether the apportionment is in lieu of or in addition to maintenance; and
>
> (10) the reasonable opportunity of each spouse for future acquisition of capital assets and income.
>
> (d) The court may protect and promote the best interests of the children by setting aside a portion of the jointly or separately held estates of the parties in a separate fund or trust for the support, maintenance, education, and general welfare of any minor, dependent, or incompetent child of the parties. [Section 503(c), (d), Marriage Act.]

Thus, the assets of a marriage are to be divided much like the distribution of assets pursuant to a dissolution of a partnership. The primary objective of the court is to effect a division of marital property in order to put the parties in a position from which they can start anew. In re Marriage of Lee, 78 Ill. App. 3d 1123, 398 N.E.2d 126, 133 (1979). Thus, the legislative intent in promulgating the Marriage Act is to:

> create a system of property division upon dissolution of marriage that is more equitable than that which previously existed in this State. * * * For instance, by giving both spouses an interest in "marital property" upon dissolution of marriage, the legislature sought to award economic credit in the distribution of property for indirect or domestic contributions to the accumulation of property and sought to replace the concept of post marital support through alimony with one of post-marital stability through a just distribution of marital property and assets. * * * [Kujawinski

v. Kujawinski, 71 Ill. 2d 563, 376 N.E.2d 1382, 1388 "(1978); emphasis supplied.]"

Following the objectives stated above, Illinois courts hold that the right to a pension or profit sharing interest is "property" under section 503 of the Marriage Act. In re Marriage of Hunt, 78 Ill. App. 3d 653, 397 N.E.2d 511, 516 (1979). "Accordingly, it is clear that the pension benefits, to the extent they were earned during the marriage, are marital property although they will not actually be paid until after the marriage has been dissolved." Pieper v. Pieper, 79 Ill. App. 3d 835, 398 N.E.2d 868, 871-872 (1979). See also In re Marriage of Campise, 115 Ill. App. 3d 610, 450 N.E.2d 1333, 1337 (1983); In re Marriage of Smith, 114 Ill. App. 3d 47, 448 N.E.2d 545, 549 (1983). Thus, the State of Illinois treats an individual's interest in a pension right as a right in property and not as a right to future income. In re Marriage of Fairchild, 110 Ill. App. 3d 470, 442 N.E.2d 557, 561 (1982).

Notwithstanding the weight of Illinois law in this area, petitioner-Joseph argues that the division of pension rights cannot be considered a division of "property" for Federal tax purposes because of the United States Supreme Court decision in McCarty v. McCarty, 453 U.S. 210 (1981). In McCarty, the Supreme Court determined that a community property state court could not divide, as part of the marital property, a non-disability military retirement pension. The retirement pension was the exclusive benefit of the military serviceman. The Court relied on the argument that to decide otherwise would threaten great harm to a clear and substantial Federal interest. This decision was rendered on June 26, 1981, eleven days after the Lake County Circuit Court entered the Judgment for Dissolution of Marriage for Mildred and Joseph. Neither party appealed the state court's decision and the Judgment became final.

Subsequent to the McCarty decision the Illinois Supreme Court recognized that military non-disability retirement pay could no longer be apportioned by the state courts pursuant to a dissolution of marriage. In re Marriage of Musser, 87 Ill. 2d 68, 429 N.E.2d 530, 531 (1981). However, for all judgments of dissolution entered before the decision in McCarty and not appealed thereafter, the doctrine of res judicata applies. This is true even when the final unappealed judgment may be wrong or rest on a legal principle which has been overruled. Federated Dept. Stores v. Moitie, 452 U.S. 394, 398 (1981). "A final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action." Commissioner v. Sunnen, 333 U.S. 591, 597 (1948).

Since the Judgment entered on June 15, 1981 was never appealed and became final, the McCarty decision is precluded from having an effect because of the doctrine of res judicata. Accordingly, the pension rights apportioned in the Judgment were properly adjudged to be property rights under existing Illinois law and were equitably divided pursuant to a dissolution of marriage.

This result would obtain even if the doctrine of res judicata did not exist. The year after McCarty was decided, Congress made its disagreement with the decision apparent. In the Uniform Former Spouses' Protection Act, Pub. L. 97-252, 96 Stat. 718, 730-738 (1982), Congress decreed (at section 1002(a)) that "a court may treat disposable retired or retainer pay payable to a member for pay periods beginning after June 25, 1981, either as property solely of the member or as property of the member and his spouse in accordance with the law of the jurisdiction of such court." Codified at 10 U.S.C. section 1408(c)(1)(1982). **See,** Savings and Profit Sharing Fund of Sears Employees v. Gago, 717 F.2d 1038 (7th Cir. 1983). In effect, Congress legislated the McCarty decision out of existence by making the legislation retroactive to the day before the decision in McCarty.

Therefore, in accordance with the reasons stated above, Mildred need not include in income, under section 71(a), the portion of the pension payments she received in 1981 pursuant to the Judgment. Because of this conclusion, Joseph may not deduct, under section 215, the portion of the pension payments turned over to Mildred pursuant to the Judgment.[7]

Decisions will be entered

under Rule 155.

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[7] It cannot be ascertained from the Stipulation of Facts or the exhibits attached thereto, as to how the taxes on the pension payments were to be computed. The Judgment stated that Mildred should receive one-half of the government retirement check. Further, it stated that "[t]he government retirement check shall be the gross check minus only the taxes due on said amount." It is assumed that the "taxes" referred to are the Federal taxes withheld from the entire pension payment rather than the actual taxes that Joseph would have to pay due to the inclusion of the check in his gross income for tax purposes.

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UNITED STATES TAX COURT

ROBERT MONTANO, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 19494-83. Filed May 14, 1986.

Robert Montano, pro se.

Steven Mather and Harry Morton Asch, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

CLAPP, Judge: Respondent determined a deficiency in petitioner's Federal income tax for the taxable year 1978 in the amount of $21,523.00 and an addition to tax under section 6653(b)[1] in the amount of $10,322.94. After concessions, the sole issue for decision is whether petitioner is liable for the addition to tax under section 6653(b).

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The stipulation of facts and attached exhibits are incorporated herein by this reference. Petitioner, Robert Montano, resided in Montebello, California, when he filed his petition in the instant case.

Petitioner began working as a real estate salesman in 1966 and became a real estate broker in 1968. Beginning in 1974 and continuing throughout 1978 and thereafter, petitioner was employed by A.P. Lopez, an individual doing business as A.P. Lopez Realty. A.P. Lopez Realty was engaged in the business of acquiring, rehabilitating and reselling pieces of improved real property. Petitioner's duties as an employee of A.P. Lopez Realty included commission sales as well as the finding and acquiring of real properties for resale.

During 1978, petitioner earned and received commissions on sales of $40,369.00 which sum was set forth by A.P. Lopez Realty on a Form 1099. Petitioner reported only this amount as gross income on his 1978 Federal income tax return. Petitioner filed an amended 1978 Federal income tax return, dated June 2, 1980, which again reported only the commission income but claimed business and itemized deductions.

In addition to this commission income, petitioner also received income in the amount of $26,532.96 for his services in locating and arranging for the acquisition of various properties on behalf of A.P. Lopez Realty (these amounts are hereinafter referred to as finders fees). Mr. Lopez would typically take and hold title to these properties. Upon resale of the properties, the agreed arrangement was that Mr. Lopez received 50 percent of the profit and whoever located the properties received the other 50 percent. Richard Quesada, another employee of A.P. Lopez Realty, had a separate agreement with petitioner to split their shares between them. For each property sale, settlement sheets were drawn up by Carlos Sinde, a bookkeeper employed by A.P. Lopez Realty from 1969 to 1980. These sheets set forth costs incident to the purchase, management, rehabilitation and sale of each property, total rental income received and the proceeds of sale. The settlement sheets computed a net profit figure for the entire transaction and reflected the portion of the net profit allocable to petitioner. The settlement sheets conventionally were captioned with a title including the legend, "Joint Venture. A.P. Lopez - Robert Montano - Richard Quesada." Mr. Sinde would prepare these statements after receiving the necessary information from Mr. Lopez. The accounting should have been completed within two months after escrow of the sale but the statements were often prepared six months and up to a year later for some. However, the statements were prepared within the time which Mr. Lopez had to file his tax return including extensions. After the settlement sheets were prepared, Mr. Sinde would give a copy to petitioner and would make entries on the employee ledger cards crediting petitioner with the finders fees. The ledger cards were available to petitioner. Any disagreement petitioner may have had with the amounts shown on the sheets was that the figures were too low and that he was entitled to more income.

The table below (which was agreed to by the parties) identifies the property sold, the closing date, the amount of petitioner's share and the date when the credit was entered on the employee ledger card.

Property	Escrow close	Montano Share	Joint Exh.	Ledger Card Credit
3007 Sierra St., L.A.	02/10/78	$ 1,149.45	4-D	05/25/79
130 N. Arizona, L.A.	03/10/78	3,860.35	5-E	09/30/78
7012-7018 Middleton, H.P.	05/12/78	7,961.68	6-F	05/25/79
7019 Middleton, H.P.	05/26/78	6,062.29	7-G	04/01/79
6713 Malabar St., H.P.	06/22/78	1,235.02	8-H	04/01/79
6518 Malabar St., H.P.	08/22/78	2,348.35	9-I	04/01/79
6210 Malabar St., H.P.	09/06/78	2,028.21	10-J	04/01/79
6827 Georgia Ave., Bell	10/18/78	1,079.18	11-K	04/01/79
7016 Malabar St., H.P.	10/30/78	(1,700.74)	12-L	04/01/79
8432 Chestnut St., S.G.	11/14/78	2,509.17	13-M	05/25/79
		$26,532.96		

No portion of the finders fees was reported as gross income by petitioner on either the original or the amended tax returns filed by petitioner.

In some cases, the properties acquired by A.P. Lopez were resold in exchange for promissory notes representing all or a portion of the purchase price above pre-existing financing. These notes were in some cases held for collection and in other cases the notes were sold after a period of time to third parties. In certain cases, petitioner was allocated an interest in such notes, and payments received either from monthly principal and interest collections or from resale of the notes would be allocated to petitioner. The amounts received from the notes receivable were credited monthly on the ledger cards. The total of cash loan payment proceeds received by A.P. Lopez Realty in 1978 and allocable to petitioner was $9,017.04. In addition to the aforesaid income amount, petitioner was credited on the 1978 employee ledger cards with certain other specific items of income totalling $4,075.96.

Petitioner was entitled to cash draws based on the amount of anticipated profits prior to the completion of the accounting work. These cash draws were noted on the employee ledger cards as debits to petitioner's account. Petitioner received cash draws totalling $72,220 in 1978 which amount roughly coincided with the amount of commission income, finders fees and collection for notes receivable.

Petitioner failed to keep or maintain adequate records of his dealings with A.P. Lopez Realty as well as records of his own outside property interests. During the audit which began in 1981, petitioner did not furnish the agent with any of the settlement sheets. Petitioner represented to the agent that he did not have a joint checking account with Quesada when in fact he did. Petitioner also represented to the agent that he did not have a power of attorney for Quesada to deal with the real property when in fact he did possess such a power of attorney.

Petitioner owns an interest in approximately 20 properties outside of his relationship with A.P. Lopez Realty. Petitioner rarely holds title to any of these properties in his own name ostensibly because of his poor credit rating.

The underpayment of tax for the year 1978 is due to fraud with intent to evade taxes.

OPINION

Petitioner has conceded the adjustments to taxable income made by respondent. The sole issue remaining for decision is whether petitioner is liable for the addition to tax under section 6653(b) for fraud.

Respondent bears the burden of proving, by clear and convincing evidence, that there is an underpayment of tax and that some part of this underpayment is due to fraud. Section 7454(a); Rule 142(b), Tax Court Rules of Practice and Procedure. This burden is met if it is shown that the taxpayer intended to conceal, mislead or otherwise prevent the collection of such taxes. Rowlee v. Commissioner, 80 T.C. 1111, 1123 (1983). The presence or absence of fraud is factual, to be determined upon consideration of the entire record. Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). Fraud is never presumed. Beaver v. Commissioner, 55 T.C. 85 (1970). Fraud may, however, be proved by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. The taxpayer's entire course of conduct may establish the fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971).

Respondent has carried his burden of proving that there was an underpayment of tax for 1978. The record is clear, and petitioner has in fact conceded, that petitioner received all the income respondent had determined in the notice of deficiency in an amount sufficient to produce an underpayment for 1978.

Respondent has also carried his burden of proving that the underpayment was due to fraud. Petitioner received but did not report a total of $39,625.86 ($26,532.96 + $13,092.90), an amount over 100 percent of the amount of income that he did report. Petitioner's only excuse for the understatement of income is that he did not receive the necessary information from A.P. Lopez Realty to calculate his tax. Petitioner testified that even when he filed his amended return in June 1980 he did not have the settlement sheets which computed his finders fees. Yet the parties stipulated that petitioner's finders fees were posted on the employee ledger cards no later than May 1979. The entries on the ledger cards were made only after the settlement sheets were completed. The income from the collections on the notes receivable were posted monthly on the ledger cards. Both the settlement sheets and the ledger cards were readily available to petitioner. Petitioner's explanation is contrary to the evidence and totally unpersuasive. Such a deliberate omission of income is indicative of fraudulent intent on the part of petitioner. Smith v. Commissioner, 32 T.C. 985, 987 (1959).

According to petitioner's own testimony, he failed to keep or maintain adequate records of his dealings with A.P. Lopez Realty as well as records of his own outside property interests as required by section 6001. Failure to keep such records is an indication of fraud. Estate of Upshaw v. Commissioner, 416 F.2d 737 (7th Cir. 1969). During the investigation, which commenced in 1981, petitioner provided misleading statements to respondent's agent concerning his bank accounts and his property dealings. He failed to furnish the agent with the settlement sheets. Petitioner's explanation again was that they were not available to him. The evidence is otherwise. Such conduct in providing false and misleading statements to a revenue agent is also indicative of fraud. Gromacki v. Commissioner, 361 F.2d 727 (7th Cir. 1966). In addition, petitioner concealed his ownership of property by holding title in the names of others. Such concealment is also evidence of fraud. Furnish v. Commissioner, 262 F.2d 727, 729 (9th Cir. 1958).

Based on the foregoing, we hold that respondent has established by clear and convincing evidence that the underpayment of tax for year 1978 was due to fraud with intent to evade taxes and, therefore, respondent's determination of an addition to tax under section 6653(b) is sustained.

Decision will be entered

for the respondent.

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UNITED STATES TAX COURT

ROBERT SINGER, Petitioner v. COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 18738-85. Filed May 14, 1986.

Darryl V. Rippy, for the petitioner.

George Nassif, for the respondent.

MEMORANDUM OPINION

BUCKLEY, Special Trial Judge: This matter was assigned to the undersigned pursuant to Rules 180, 181 and 183, Tax Court Rules of Practice and Procedure. It is before us on respondent's motion to dismiss for lack of jurisdiction.

jl

Petitioner on June 18, 1985, filed a petition to this Court in regard to his 1982 taxable year. He alleged therein that he had not received a notice of deficiency from respondent for that year and argued that none was mailed or, alternatively, that it was not sent to petitioner's last known address in accordance with section 6212.[1] Petitioner resided at Calabasas, California, at the time of filing his petition herein.

A statutory notice of deficiency was mailed by certified mail to petitioner on August 1, 1984, regarding his 1982 taxable year. The notice was mailed to him at 7131 Owensmouth, Suite 96D, Canoga Park, California 91303. There is no indication that the notice was returned to respondent. That address was the one shown on petitioner's 1982 tax return.

If respondent's notice was sent to petitioner's last known address, the petition to this Court must have been filed on or before October 30, 1984, in order for it to be timely and for this Court to have jurisdiction over this matter. Sec. 6213. As noted, the petition in fact was filed June 18, 1985.

Petitioner's 1983 Federal income tax return was filed on or before April 16, 1984. The address shown on that return was P.O. Box 162, Agoura Hills, California 91301. Petitioner contends that respondent at the time of mailing the notice of deficiency to petitioner on August 1, 1984, had notice of petitioner's new address at Agoura Hills as a result of the new address shown on petitioner's 1983 return. Thus, petitioner contends that the notice of deficiency was not sent to petitioner's last known address and hence was invalid.

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[1] Section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

Our question is therefore whether respondent had reasonable knowledge of the fact that petitioner's address had changed from Canoga Park to Agoura Hills when respondent mailed the deficiency notice. This is, of course, a question of fact. Maxfield v. Commissioner, 153 F.2d 325, 327 (9th Cir. 1946). The Internal Revenue Service, as a general rule, is entitled to treat the address appearing on the return for the year in question as to the last known address, absent "clear and concise notification" of a new address. Alta Sierra Vista, Inc. v. Commissioner, 62 T.C. 367, 374 (1974), affd. without published opinion 538 F.2d 334 (9th Cir. 1976). We recognize that the "last known address" to which the notice of deficiency is mailed assumes great importance in the taxpayer's ability to obtain a prepayment judicial redetermination of his tax liabilities. Unfortunately, the phrase "last known address" is not defined in the applicable Code section or attendant regulations. We held in Brown v. Commissioner, 78 T.C. 215, 218-219 (1982), that this phrase means:

> the taxpayer's last permanent address or legal residence known by the Commissioner, or the last known temporary address of a definite duration to which the taxpayer has directed the Commissioner to send all communications during such period. Weinroth v. Commissioner, 74 T.C. 430, 435 (1980); Alta Sierra Vista, Inc. v. Commissioner, 62 T.C. 367, 374 (1974), affd. without published opinion 538 F.2d 334 (9th

> Cir. 1976). Stated otherwise, it is the address to which, in light of all the surrounding facts and circumstances the respondent reasonably believed the taxpayer wished the notice to be sent. Weinroth v. Commissioner, supra; Looper v. Commissioner, 73 T.C. 690, 696 (1980). The relevant focus is thus on the Commissioner's knowledge rather than on what in fact may have been the taxpayer's actual address in use. Alta Sierra Vista, Inc. v. Commissioner, supra.

We have held, generally, that the filing of a subsequent return with a change of address does not constitute such clear and convincing evidence. Weinroth v. Commissioner, 74 T.C. 430, 436-437 (1980); Budlong v. Commissioner, 58 T.C. 850, 852-853 (1972). However, we follow, for purposes of this matter,[2] the holdings of the Ninth Circuit to the effect that a subsequently filed tax return with a new address does give the Internal Revenue Service notice of the new address. See, e.g., United States v. Zolla, 724 F.2d 808, 810 (9th Cir. 1984). We must face the question here, however, as to just when the Internal Revenue Service had such notice, whether on the filing date of the 1983 return or at some other time subsequent thereto. If the Internal Revenue Service did not have effective notice until after August 1, 1984, of a change of address, our jurisdiction over this matter must fail. Petitioner's 1983 return was timely filed on or prior to April 16, 1984, with the Fresno Service Center of the Internal Revenue Service. The transcript of the Internal

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[2] Golsen v. Commissioner, 54 T.C. 742 (1970), affd. 445 F.2d 985 (10th Cir. 1971), cert. denied 404 U.S. 940 (1971). Since any appeal herein lies to the Ninth Circuit, we follow that Court for purposes of our determination of jurisdiction herein.

Revenue Service's National Computer Center indicates that petitioner's new address as indicated on his 1983 tax return was not posted until September 17, 1984, some 47 days after the issuance of the notice of deficiency. The delay between the return's timely filing date of April 16, 1984, and the computer posting of petitioner's 1983 return was, therefore, at least 22 weeks, or approximately five months. Respondent's procedure for the posting of return information, during the peak processing period, is to set aside returns that come in fully paid in order to process first returns upon which refunds are claimed. Respondent's operating goal during peak processing times is to have posting of refund returns completed within eight to ten weeks. After the refund returns are posted, the Service Center then turns to the handling of non-refund returns. Petitioner's 1983 return was such a return.

When the returns are received in the mailroom of the Service Center, they are placed in batches of 100 similar returns. They are forwarded to a group called Returns Analysis where they are reviewed for completeness, then a Document Locater Number is stamped in the upper right hand portion of the return. Next, returns are forwarded to a computer area and entered in the computer, where if the computations are correct, they are placed on magnetic tape. The magnetic tape is then forwarded to the National Computer Center in Martinsburg, West Virginia, where it is merged and cross-checked with information stored and maintained for the entire country. The National Computer Center then creates another magnetic tape which is then forwarded back to the Service Center, in this instance, Fresno. It is only at that point on September 17, 1984, that the information contained on the return about petitioner's new address became available to respondent for discovery. Respondent's transcript indicates that petitioner's 1983 return was handled by the Service Center in the normal course of its business.

The mere fact that the 1983 return was filed on or before April 16, 1984, does not serve to provide respondent with actual notice of petitioner's change of address. It would be unreasonable to ascribe respondent with notice solely because of physical control of the return at the Fresno Service Center. We take notice of the fact that the Fresno Service Center handled great numbers of returns during this period.

Petitioner does not allege that he notified the Internal Revenue Service of an address change nor that the notice of deficiency was returned to the Internal Revenue Service from his Canoga Park address so as to give them notice of an address change. We note that even had it been returned to the Internal Revenue Service after its issuance, petitioner's new address would not have been available to them until September. Nothing occurred in this matter to alert the Internal Revenue Service that the notice had not in fact been received by petitioner. Compare Wallin v. Commissioner, 744 F.2d 674 (9th Cir. 1984).

Under the circumstances herein, we find that the Internal Revenue Service acted reasonably in mailing the notice of deficiency to Canoga Park. Petitioner had not, as a practical matter, advised the Internal Revenue Service of his change of address as of the date of mailing of the notice. See Bagwell v. Commissioner, T.C. Memo. 1984-93. There is nothing in the record to indicate that prior to the issuance of the statutory notice, respondent had any communication with petitioner at his new address. Cf. Pyo v. Commissioner, 83 T.C. 626 (1984). Further, no information whatsoever has been presented to indicate that the Internal Revenue Service knew that petitioner did not receive the notice.

Since our jurisdiction is predicated upon the timely filing of a petition to this Court within 90 days of the issuance of the deficiency notice (sec. 6213) and since petitioner failed to so file, we must grant respondent's motion to dismiss for lack of jurisdiction.

An appropriate order will be issued.

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Ju 11.7/2: 1986-194

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T. C. Memo. 1986-194

UNITED STATES TAX COURT

VIRENDRA R. K. AND KATHRINE TEWARI, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 623-84. Filed May 15, 1986.

Held: (1) Absent election, Ps not entitled to NOL carryover where carryback would have absorbed NOL; and (2) sales tax paid on refrigerator could not be added to sales tax table amount to determine State sales tax deduction.

Virendra R. K. and Kathrine Tewari, pro se.

Val Albright, for the respondent.

MEMORANDUM OPINION

SIMPSON, Judge: The Commissioner determined deficiencies in the petitioners' Federal income taxes of $1,256.00 for 1980 and $1,682.00 for 1981. The issues for decision are: (1) Whether the petitioners are entitled to a carryover of net operating losses incurred in 1976 and 1977 to 1980 and 1981; and (2) whether the petitioners are entitled to claim a deduction for sales tax paid on the purchase of a refrigerator when they used the sales tax table to determine the amount of such deduction for all other items purchased.

All of the facts have been stipulated, and those facts are so found.

The petitioners, Virendra R. K. and Kathrine Tewari, husband and wife, maintained their residence in Dallas, Tex., at the time they filed their petition in this case.

Mr. Tewari, who will sometimes be referred to as the petitioner, filed individual Federal income tax returns for 1976 and 1977 on November 15, 1979, with the Internal Revenue Service Center, Ogden, Utah. On such returns, he reported net operating losses of $26,802 for 1976 and $6,714 for 1977.

On February 27, 1980, he filed two applications for tentative refund to carry back such losses to 1973, 1974, and 1975. By letters dated April 4, 1980, such applications were disallowed. Both letters suggested the filing of an amended return to carryback such losses. If properly claimed, such losses would have been absorbed by the carryback. There is no evidence that he took any further action with respect to such carryback.

The petitioners timely filed a joint return for 1980 in which they reported a net operating loss carryover from 1976 and 1977 of $9,697. Also, in addition to the amount allowed in the sales tax table, they deducted $35 for sales tax on the purchase of a refrigerator. A joint return for 1981 was timely filed, and a carryover of $8,670 was reported.

The Commissioner, in his notice of deficiency disallowed such carryovers and the $35 sales tax deduction. Additionally, he made adjustments for 1980, which are not challenged.

The first issue to be decided is whether the petitioners are entitled to carryover net operating losses incurred in 1976 and 1977 to 1980 and 1981. The petitioners bear the burden of proving that the Commissioner's determinations in the notice of deficiency are incorrect. Rule 142(a), Tax Court Rules of Practice and Procedure; Welch v. Helvering, 290 U.S. 111 (1933). Specifically, the petitioners must show that the amounts claimed by them to be deductible satisfy the requirements of the appropriate statutory provisions. Deputy v. duPont, 308 U.S. 488, 493

(1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934).

Section 172 provides for the allowance of a deduction for a taxable year of an amount equal to the aggregate of the net operating loss carryover to such year plus the net operating loss carryback to such year. Such section provides, insofar as it is applicable to this case, that a net operating loss shall be first carried back to each of the 3 years preceding such occurrence, and if not absorbed by such carryback, the remaining portion may be carried over to each of the succeeding 15 taxable years.

Section 6411 establishes procedures whereby taxpayers can file applications and secure tentative refunds resulting from carrybacks of net operating losses. The petitioner filed such applications, but such applications were not filed within the required time--1 year after the loss. Consequently, he lost his right to secure a tentative refund by reason of the carrybacks to 1973, 1974, and 1975. However, the Commissioner advised him to file amended returns while the statute of limitations was still open for doing so, but there is no evidence that he ever filed any such amended returns.

Under section 172(b)(3)(C), a taxpayer who is entitled to a net operating loss carryback may elect not to claim a carryback. Such election shall be made by the due date, including extensions of time, for filing the taxpayer's return for the taxable year of the net operating loss for which the election is to be in effect. If the election is not made, a carryover is allowable only to the extent that the loss exceeds the taxable income for the years of a carryback, regardless of whether a carryback was in fact claimed. Sec. 172(b)(2); sec. 1.172-4(b)(1), Income Tax Regs.

There is no evidence that the petitioner filed such an election. In addition, it was agreed that, if properly claimed, the net operating losses would have been entirely absorbed during the carryback period. Therefore, we must conclude that the petitioners are not entitled to any carryover for 1980 and 1981.

The final issue to be decided is whether the petitioners are entitled to claim a deduction for sales tax paid on the purchase of a refrigerator when they used the sales tax table to determine the amount of such deduction for all other items purchased by them.

Section 164 allows a deduction for State and local general sales taxes. Instead of deducting the actual tax paid, the taxpayer may use the sales tax table published by the Commissioner in determining the amount of such deduction. The only sales taxes that may be added to the amounts allowable in the tax table are those paid when purchasing extraordinary items, such as a car or motor home.[1]

The petitioners elected to use the Commissioner's table, and they have presented no evidence to establish that the refrigerator is an extraordinary item. Therefore, the Commissioner's determination is sustained.

Decision will be entered
for the respondent.

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[1] See Groff v. Commissioner, T. C. Memo. 1984-252; Meyen v. Commissioner, T. C. Memo. 1982-536; Henson v. Commissioner, T. C. Memo. 1979-110.

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T. C. Memo. 1986-195

UNITED STATES TAX COURT

GEOFFREY A. WILLIAMS, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 301-84. Filed May 15, 1986.

Held: (1) P had unreported income; and (2) P failed to substantiate claimed deductions.

Geoffrey A. Williams, pro se.

James E. Polk, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SIMPSON, Judge: The Commissioner determined a deficiency of $6,734.97 in the petitioner's Federal income tax for 1981. The issues for decision are: (1) Whether the petitioner understated his gross income in the amount determined by the Commissioner; and (2) whether the petitioner substantiated any of the deductions that were claimed on his income tax return and not allowed by the Commissioner.

FINDINGS OF FACT

The petitioner, Geoffrey A. Williams, maintained his residence in Dallas, Tex., at the time he filed his petition in this case. He filed a Federal income tax return for 1981 with the Internal Revenue Service.

In the notice of deficiency, the Commissioner determined that in 1981, the petitioner received income which was not reported on his income tax return of $3,213.00 from Massachusetts Indemnity Life Insurance Co. and $3,371.00 from American Bankers Life Assurance Co. Schedule C expense deductions of $11,633.00 and itemized deductions of $6,538.00 were not allowed. Finally, it was determined that Mr. Williams was liable for $871.97 of self-employment tax.

During the opening statements, Mr. Williams raised the possibility that documents in his possession that might substantiate his claimed deductions were privileged under the Fourth or Fifth Amendment and that the Thirteenth Amendment might provide him with further protection. The petitioner was not under any criminal investigation, and the Court advised him that the privileges he sought to invoke were not applicable. Additionally, the Court clearly stated that his refusal to produce such documents would result in the Commissioner's determination being sustained. Mr. Williams refused to produce any documentation.

OPINION

The first issue to be decided is whether the petitioner understated his gross income in the amount determined by the Commissioner. The Commissioner has conceded that Mr. Williams reported $3,371 from American Bankers Life Assurance Co. on his income tax return. Therefore, the only question remaining is whether he reported $3,213 from Massachusetts Indemnity Life Insurance Co.

Gross income includes all income from whatever source derived. Sec. 61(a), Internal Revenue Code of 1954.[1] The Commissioner may prove the existence and amount of unreported income by any method that will, in his opinion, clearly reflect the taxpayer's income. Sec. 446(b); see Holland v. United States, 348 U.S. 121, 130-132 (1954);

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[1] All statutory references are to the Internal Revenue Code of 1954 as in effect during the year in issue.

Campbell v. Guetersloh, 287 F.2d 878, 880 (5th Cir. 1961); Davis v. Commissioner, 239 F.2d 187, 189 (7th Cir. 1956), affg. a Memorandum Opinion of this Court. The petitioner bears the burden of proving that the Commissioner's determination is erroneous. Rule 142(a), Tax Court Rules of Practice and Procedure[2]; Cracchiola v. Commissioner, 643 F.2d 1383, 1385 (9th Cir. 1981), affg. per curiam a Memorandum Opinion of this Court; Marcello v. Commissioner, 380 F.2d 494, 497 (5th Cir. 1967), affg. on this issue a Memorandum Opinion of this Court; Harper v. Commissioner, 54 T.C. 1121, 1129 (1970).

The petitioner did not present the Court with any evidence concerning this issue. Therefore, Mr. Williams failed to meet his burden of proof, and the Commissioner's determination is sustained.

The second issue to be decided is whether the petitioner substantiated any of the deductions that were claimed on his income tax return and not allowed by the Commissioner. Section 162(a) allows a deduction for ordinary and necessary expenses incurred in carrying on a trade or business. Under section 63(b), in arriving at taxable income, a taxpayer may deduct his excess itemized deductions. The petitioner has the burden of proving that the amounts claimed by him to be deductible satisfy the requirements of the appropriate statutory provision. Rule 142(a); *Deputy v. duPont*, 308 U.S. 488, 493 (1940); *Welch v. Helvering*, 290 U.S. 111 (1933); *Roberts v. Commissioner*, 62 T.C. 834, 836 (1974); *Sanford v. Commissioner*, 50 T.C. 823, 826 (1968), affd. 412 F.2d 201 (2d Cir. 1969). Additionally, a taxpayer is required to keep books or records to substantiate all claimed deductions. Sec. 6001; sec. 1.6001-1(a), Income Tax Regs. Generally, where a petitioner does not produce any records to substantiate his deductions, disallowance of claimed deductions is proper. See *Roberts v. Commissioner*, 62 T.C. at 836.

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[2] Any reference to a Rule is to the Tax Court Rules of Practice and Procedure.

Despite continued warnings, the petitioner refused to present the Court with such records. Therefore, the Commissioner's determination concerning deductions is sustained.

Decision will be entered
under Rule 155.

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UNITED STATES TAX COURT

ALLEN N. BRUNWASSER AND BEVERLY R. BRUNWASSER, Petitioners,
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 27166-82. Filed May 15, 1986

Allen N. Brunwasser, pro se.

Edward J. Laubach, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DRENNEN, Judge: This case was assigned to Special Trial Judge Hu S. Vandervort pursuant to section 7456 and Rules 180 and 181.[1] The Court agrees with and adopts his opinion, which is set forth below.

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. All Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise stated.

OPINION OF THE SPECIAL TRIAL JUDGE

VANDERVORT, Special Trial Judge: This case is before the Court on respondent's Motion for Summary Judgment and to Award Damages Under I.R.C. Section 6673, filed May 16, 1985.[2]

In the notice of deficiency issued to petitioners on August 16, 1982, the Commissioner determined a deficiency in petitioners' Federal income tax for the taxable year 1978 in the amount of $1,864.22. The issues raised by respondent's motion are: (1) whether the statute of limitations on assessment expired prior to the issuance of the notice of deficiency for taxable year 1978; (2) whether there exists a deficiency in petitioners' 1978 Federal income taxes; and, (3) whether damages should be awarded to the United States pursuant to section 6673.

Petitioners filed their calendar year 1978 Federal income tax return on August 27, 1979, after receiving an extension of time to file such return to September 15, 1979. Petitioner Allen

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[2] This docket, No. 27166-82, is one of the three dockets pending before the Court involving the same taxpayers and similar issues. All three dockets, No. 27166-82, No. 34386-84 and No. 18193-82, are the subject of substantially similar motions for summary judgment filed by respondent on May 16, 1985.

Respondent previously filed motions for summary judgment in the cases at docket Nos. 18193-82 and 27166-82 on September 17, 1984. The Court conducted a hearing on these motions in Pittsburgh, Pennsylvania before the Honorable Charles E. Clapp II on November 26, 1984. However, before the conclusion of this hearing Judge Clapp recused himself. The hearing was concluded and respondent's motions were denied without prejudice. On May 16, 1985 respondent filed the motion currently before the Court.

N. Brunwasser (Allen) signed the return on August 15, 1979 and petitioner Beverly Brunwasser (Beverly) signed the return on August 19, 1979.

Petitioners' 1978 Federal income tax return reflected a tax liability of $65,140.70. In arriving at this figure, petitioners chose not to itemize deductions, instead claiming the zero bracket amount as their deduction. The instructions on Form 1040 for 1978 stated that taxpayers who do not itemize deductions shall enter 0 on line 33 of Form 1040. Contrary to these instructions, petitioners entered $3,200 (the zero bracket amount for married couples filing a joint return pursuant to section 63(d)(1)(A), as in effect for taxable year 1978) on line 33. Petitioners then used Schedule TC to calculate the tax due. However, the Schedule TC tables incorporate the $3,200 zero bracket amount deduction. Thus, in effect, petitioners deducted the zero bracket amount twice on their 1978 Form 1040.

On October 15, 1979, the Commissioner made a section 6213(b)(1) assessment of tax due and owing from petitioners for 1978 based upon the alleged mathematical or clerical error.[3] Thereafter, a bill was sent to petitioners requesting payment of

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[3] Section 6213(b) permits the Commissioner of Internal Revenue to make an immediate assessment with respect to mathematical or clerical errors. However, section 6213(b)(2) provides for the abatement of an assessment of mathematical or clerical errors if the taxpayer files with the Secretary, within 60 days after notice is sent, a request for the abatement of any assessment due to mathematical or clerical error.

$4,167.53. This figure was based upon petitioners' alleged mathematical or clerical error concerning the double deduction ($1,864.22), petitioners' failure to pay estimated taxes ($1,804.96) and the interest due upon these amounts ($498.35).[4] After receiving the bill for the additional tax, penalty and interest petitioners questioned the reason for such an assessment. The Commissioner treated petitioners' inquiry as a request for abatement of an assessment arising out of a mathematical or clerical error and abated the assessment pursuant to section 6213(b)(2)(A).

Subsequent to the section 6213(b)(2) abatement, respondent conducted an audit of petitioners' 1978 income tax return. Respondent and petitioners reached an agreement with respect to the audit adjustments and petitioners paid the resulting deficiency. However, during the audit, no action was taken with respect to the double deduction that was the subject of the section 6213(b)(1) mathematical error assessment.

Thereafter, on August 16, 1982, respondent issued a notice of deficiency based upon petitioners' claimed double deduction on their 1978 Federal income tax return. Petitioners filed a timely petition and subsequently respondent filed the motion now before the Court.

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[4] It is the Court's understanding that petitioners have filed an action in the United States District Court for the Western District of Pennsylvania with regard to the addition to tax for failure to pay estimated taxes.

On July 11, 1985, at a special trial session of the Court, in Pittsburgh, Pennsylvania, the parties were given a chance to present oral argument regarding respondent's motion. However, there was no appearance by or on behalf of petitioners.[5]

Rule 121(b) states that a decision on a motion for summary judgment shall be rendered "if the pleadings, * * * and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law."

Thus, in deciding a motion for summary judgment we must clearly determine that there are no issues of material fact in dispute. Season-All Industries, Inc. v. Turkiye, 425 F.2d 34 (3rd Cir. 1970); Gulfstream Land & Development Corp. v. Commissioner, 71 T.C. 587 (1979). The burden of demonstrating that there is no genuine issue of material fact is upon the moving party. *Adickes v. Kress & Co.*, 398 U.S. 144, 157 (1970); *Graf v. Commissioner*, 80 T.C. 944, 946 (1983); *Jacklin v. Commissioner*, 79 T.C. 340, 344 (1982).

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[5] Petitioners were notified of the date, place and time of the hearing by an order of the Court. Petitioners transmitted an appeal to the United States Court of Appeals for the Third Circuit by mailing it to the United States Tax Court in Washington, D.C. Since this was an interlocutory appeal, the appeal was returned to petitioners. See section 7483; Rule 190. In a letter accompanying the returned document, it was explained to petitioners that an appeal at this time was premature as no decision had yet been entered by the Court in this case. Petitioner, Allen Brunwasser, was advised by telephone on the day before the date of the hearing that the hearing would proceed as scheduled. Petitioners chose not to attend and were not represented at the hearing.

Petitioners argue that this case should not be disposed of on a motion for summary judgment because discovery has not yet been completed. Clearly, a motion for summary judgment should not be granted if a pertinent discovery request is outstanding. *Sames v. Gable*, 732 F.2d 49 (3rd Cir. 1984). However, we do not find this to be the case.

Petitioner submitted an application to take depositions of three present or former Internal Revenue Service employees. Respondent opposed petitioners' application. No action was taken by the Court with respect to petitioners' application because it did not conform to the Rules of this Court. See Rules 70, 74 and 75. The taking of depositions for discovery purposes is not available under the Tax Court Rules of Practice and Procedure except to the limited extent provided in Rules 74 and 75. Rule 70(a).

Rule 74 allows depositions to be taken in a pending case of a party, or non-party witness only upon the consent of all parties to the case. Rule 75 is an extraordinary method of discovery where a non-party may be deposed without the consent of the parties in the case. Petitioners have not shown that they should have been allowed to take depositions under either of these Rules. Petitioners could have subpoenaed the individuals they desired to depose to secure their testimony at the hearing on respondent's motion. Not only did petitioners fail to avail themselves of this preferable alternative to taking depositions, petitioners themselves did not appear at the hearing.

The Rules of this Court exist to assist those appearing before this Court prepare and present their case: they are meant to be followed. Petitioner - Allen, a capable attorney, has made no demonstrable attempt to abide by the rules of this Court. Despite petitioners' argument to the contrary, no discovery is currently pending in this case.[6] Therefore, we find this case to be properly before the Court on a motion for summary judgment.

Petitioners argue that the statute of limitations expired prior to August 16, 1982, the date on which the Commissioner's statutory notice of deficiency was mailed to petitioners. Based on the record in this case, we cannot agree with petitioners. In every aspect, we find that the notice of deficiency was proper and timely.

Pursuant to section 6501(a) the period for making a timely assessment is "within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed [for filing])." When a tax return is received by the Internal Revenue Service within the period for which an extension of time to file is in effect, the date of filing is the date the return is received. First Charter Financial Corp. v. United States, 669 F.2d 1342 (9th Cir. 1982); Pace Oil Company v. Commissioner, 73 T.C. 249 (1979).

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[6] Assuming arguendo that a valid application to take depositions was pending in this Court, such request for discovery must be pertinent to the particular case. Petitioners desire to take the depositions of the Pittsburgh District Counsel of the Internal Revenue Service and two, either present or former, employees of the Internal Revenue Service. In light of the issues in this case, the deposition of these individuals would not lead petitioners to any relevant evidence.

Petitioners' 1978 Federal income tax return was received on August 27, 1979 pursuant to an extension to file up to September 15, 1979. The statute of limitations would run three years from August 27, 1979, on August 27, 1982. The notice of deficiency was mailed to petitioners on August 16, 1982, well within the three year period provided by section 6501(a). Therefore, the statute of limitations had not expired prior to the issuance of the notice of deficiency to petitioners.

Petitioners make an additional attack on the validity of the notice of deficiency as to Beverly alleging that it was not sent to her last known address. An examination of the notice of deficiency discloses that it was sent to Beverly at the address shown on petitioners' 1978 Federal income tax return. However, even assuming that the statutory notice of deficiency was not mailed to Beverly's last known address, we find the notice of deficiency valid as to Beverly.

A notice of deficiency is valid even though there are errors in the mailing address if there is a timely filed petition with this Court and, if the taxpayer suffered no damage as the result of the errors. Clodfelter v. Commissioner, 527 F.2d 754 (9th Cir. 1975); cert. denied 425 U.S. 979 (1976), affg. 57 T.C. 102 (1971); Berger v. Commissioner, 404 F.2d 668 (3rd Cir. 1968), cert. denied 395 U.S. 905 (1969), affg. 48 T.C. 848 (1967); Zaun v. Commissioner, 62 T.C. 278 (1974); Brzezinski v. Commissioner, 23 T.C. 192 (1954). In the present case, Beverly received the notice of deficiency in time to file a petition in this Court. She has suffered no damage. Therefore, the notice of deficiency is timely and valid as to both Beverly and Allen.

The second issue we must address is whether there exists a deficiency in petitioners' 1978 Federal income taxes. It is respondent's position that petitioners took a double deduction on their 1978 Federal income tax return, resulting in a deficiency for the 1978 taxable year. We agree.

On their 1978 Federal income tax return, petitioners did not itemize their expenses. Therefore, they were not entitled to enter any figure other than zero, on line 33 of Form 1040. However, petitioners entered $3,200 on line 33. Next, they calculated their tax according to Schedule TC which already incorporates the zero bracket amount of $3,200. In effect, petitioners took a double deduction.

Petitioners do not deny the presence of a double deduction on their 1978 Federal income tax return. Instead, petitioners contend that this double deduction should have been considered at the time of the audit and settlement. Therefore, petitioners conclude that the notice of deficiency is invalid.

In essence, petitioners ask us to look behind the notice of deficiency. However, this is contrary to the general rule that the notice of deficiency is presumed correct, *Welch v. Helvering*, 290 U.S. 111 (1933), and we will not look behind it. *Riland v. Commissioner*, 79 T.C. 185 (1982); *Greenberg's Express, Inc. v. Commissioner*, 62 T.C. 324 (1974). See also Rule 142. This result would obtain even where the record discloses procedural irregularities behind the issuance of the notice of deficiency, Cataldo v. Commissioner, 499 F.2d 550 (2d Cir. 1974), affg. per curiam 60 T.C. 522 (1973); Rosenberg v. Commissioner, 450 F.2d 529 (10th Cir. 1971), affg. T.C. Memo. 1970-201.[7]

We have not been presented with evidence of any procedural irregularities in this case. Petitioners asked that the section 6213(b)(1) assessment, made as the result of the alleged mathematical error, be abated. Respondent abated the assessment and is now clearly within the guidelines of section 6213 in issuing a timely notice of deficiency with respect to the double deduction. The record in this case clearly reflects that petitioners took a double deduction on their 1978 Federal income tax return. The taking of a double deduction resulted in an underpayment of tax for which petitioners are now liable.

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[7] "Except in very limited circumstances involving allegations of extraordinary misconduct, this Court has consistently refused to look behind a deficiency notice to examine respondent's motives for the administrative policy or procedure involved in making the determinations." Estate of Brimm v. Commissioner, 70 T.C. 15, 22 (1978); Graham v. Commissioner, 82 T.C. 299, 308 (1984), affd. 770 F.2d 381 (3rd Cir. 1985); Greenberg's Express, Inc. v. Commissioner, 62 T.C. 324, 327-329 (1974). "This Court has repeatedly held that it will generally not look behind the notice of deficiency to examine the evidence used or the propriety of respondent's motives or his administrative policy or procedure in making his determinations." Estate of Smith v. Commissioner, 57 T.C. 650 (1972).

"The underlying rationale for this rule is that a trial before the Tax Court is a proceeding de novo; our determination as to petitioner's tax liability must be based upon the merits of the case and not upon events preceding the trial of the case." Singleton v. Commissioner, T.C. Memo. 1977-98. Therefore, whether or not respondent's agents settle a matter at the audit stage or merely allege a deficiency and send the notice of deficiency is immaterial to the disposition of the case before this Court. Once the petitioner receives a timely notice of deficiency, he is afforded the opportunity to adjudicate the issue of the deficiency in a hearing before this Court.

Last, we must consider respondent's request that the Court award damages to the United States pursuant to section 6673. Section 6673 provides that damages not in excess of $5,000 may be awarded to the United States "[w]henever it appears to the Tax Court that proceedings before it have been instituted or maintained by the taxpayer primarily for delay or that the taxpayer's position in such proceedings is frivolous or groundless * * *."

During the pendency of this case petitioners have presented a plethora of defective arguments. Petitioner - Allen is an attorney who has apparently neither bothered to read the rules of this Court nor undertaken any research on the issues in this case.[8] Petitioners have two other cases pending before this Court; cases in which arguments are raised having little or no merit in Federal tax law. Petitioners are cautioned that if they continue to advance the same or similar arguments in future cases, this Court will award damages to the United States in accordance with section 6673.

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[8] For example, petitioners ask us to transfer this case to district court, to be joined with another tax matter pending in the United States District Court for the Western District of Pennsylvania. Clearly, we cannot divest ourselves of jurisdiction over a case once it has been properly invoked. Section 6512. We might add that our jurisdiction has been invoked by affirmative action of the petitioners themselves. See Bowser v. Commissioner, an unreported case (3rd Cir. 1977), 40 AFTR 2d 77-5531, 78-1 U.S.T.C. par. 9102; Dorl v. Commissioner, 507 F.2d 406 (2d Cir. 1974), affg. 57 T.C. 720 (1972); United States v. Wolf, 238 F.2d 447 (9th Cir. 1956).

Respondent's motion for summary judgment shall be granted to the extent of the first two issues before us and will be denied insofar as it seeks an award of damages pursuant to section 6673.

An appropriate order

will be entered.

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T. C. Memo. 1986-197

UNITED STATES TAX COURT

ALLEN N. BRUNWASSER AND BEVERLY BRUNWASSER, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 18193-82. Filed May 15, 1986.

Allen N. Brunwasser, pro se.

Edward J. Laubach, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DRENNEN, Judge: This case was assigned to Special Trial Judge Hu S. Vandervort pursuant to section 7456 and Rules 180 and 181.[1] The Court agrees with and adopts his opinion, which is set forth below.

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. All Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise stated.

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OPINION OF THE SPECIAL TRIAL JUDGE

VANDERVORT, Special Trial Judge: This case is before the Court on respondent's Motion For Summary Judgment and To Award Damages Under I.R.C. Section 6673, filed May 16, 1985.[2]

In the statutory notice of deficiency dated April 13, 1982, the Commissioner determined a deficiency in petitioners' 1977 Federal income tax in the amount of $15,700.57. The issues raised by respondent's motion are: (1) whether the statute of limitations for the taxable year 1977 had run prior to the issuance of the notice of deficiency in which the Commissioner determined petitioners were liable for an underpayment resulting from a mathematical or clerical error on their 1977 Federal income tax return; (2) whether there exists a deficiency in petitioners' Federal income taxes for 1977; (3) whether the Tax Court has jurisdiction to determine the rate of interest charged upon deficiencies in income tax; and, (4) whether damages should be awarded to the United States pursuant to section 6673.

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[2] This docket, No. 18193-82, is one of the three dockets pending before the Court involving the same taxpayers and similar issues. All three dockets, No. 27166-82, No. 18193-82 and No. 34386-84, are the subject of substantially similar motions for summary judgment filed by respondent on May 16, 1985.

Respondent previously filed motions for summary judgment in the cases at docket Nos. 18193-82 and 27166-82 on September 17, 1984. The Court conducted a hearing on these motions in Pittsburgh, Pennsylvania before the Honorable Charles E. Clapp II on November 26, 1984. However, before the conclusion of this hearing Judge Clapp recused himself. The hearing was concluded and respondent's motions were denied without prejudice. On May 16, 1985 respondent filed the motion currently before the Court.

Petitioners filed a timely 1977 Federal income tax return on or about April 15, 1978. This return reflected a tax liability of $29,658.00. After receipt of petitioners' return, the Commissioner determined that petitioners had made several mistakes calculating their 1977 tax liability.

The first mistake arose when petitioners, using Rate Schedule Y, miscalculated the tax on their taxable income of $91,279.83. Instead of arriving at the correct figure of $38,027.90, petitioners reported $28,238.00 on line 4 of Schedule TC. As a result, final tax reported on line 11 of Schedule TC was deficient by $9,789.90.

Petitioners' second mistake was made in the calculation of social security self-employment tax on Schedule SE. On line 18, where the self-employment tax is finally arrived at, petitioners reported $1,600.00. However, the instructions for line 18 state that "[i]f line 17 is $16,500, enter $1,303.50 * * *." The figure on petitioners' Schedule SE, line 17 is $16,500. Therefore, petitioners should have entered $1,303.50 on line 18, rather than $1,600.00. As a result of this error, petitioners reported an excess of $296.50 in self-employment tax.

The net result of petitioners' errors is an understatement of tax in the amount of $9,493.40. The Commissioner considered these errors to be mathematical or clerical errors as defined in section 6213(g)(2). Based on this conclusion, the Commissioner made an immediate assessment of the $9,493.40 deficiency arising from the alleged mathematical or clerical errors pursuant to section 6213(b)(1).

On August 29, 1978, petitioners requested an abatement of the mathematical or clerical error assessment. In accord with section 6213(b)(2), the Commissioner abated the mathematical or clerical error assessment on February 5, 1979. Subsequent to the abatement, an audit of petitioners' 1977 income tax return was conducted during which petitioners executed a series of waivers extending the statute of limitations.

The first unrestricted Form 872, Consent to Extend the Time to Assess Tax (Form 872) was executed on January 28, 1981, by petitioners. This consent was executed on behalf of the Commissioner on January 29, 1981. This waiver extended the period for assessment to December 31, 1981. The second Form 872 was executed by petitioners on June 26, 1981 and extended the time for assessment to March 31, 1982. This was signed on behalf of the Commissioner, but was not dated. The third Form 872 was executed by petitioners on December 28, 1981, extending the time for assessment to December 31, 1982. This waiver was signed and dated on behalf of the Commissioner on December 29, 1981.

After reaching only a partial resolution of the issues involved in the audit, the Commissioner sent a notice of deficiency to petitioners on April 13, 1982 for the taxable year 1977. The deficiency set forth in the notice was $15,700.57. However, only the $9,493.40, attributable to the alleged mathematical or clerical error, is at issue here.[3] Petitioners filed a timely petition to begin this case. On May 16, 1985, respondent filed the motion currently before the Court.

On July 11, 1985 at a special trial session of this Court, in Pittsburgh, Pennsylvania, the parties were given an opportunity to present oral argument on respondent's motion. Petitioners chose not to appear.[4]

Rule 121(b) states that a decision on a motion for summary judgment shall be rendered "if the pleadings, * * * and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law."

Thus, in deciding a motion for summary judgment, we must clearly determine that there are no issues of material fact in dispute. Season-All Industries, Inc. v. Turkiye, 425 F.2d 34

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[3] There is no dispute over the remainder of the adjustments reflected in the notice of deficiency. These adjustments, pertaining to depreciation, gross receipts and business expenses, result in a deficiency of $6,207.17.

[4] Petitioners were notified of the date, place and time of the hearing by an order of the Court. Petitioners transmitted an appeal to the United States Court of Appeals for the Third Circuit by mailing it to the United States Tax Court in Washington, D.C. Since this was an interlocutory appeal, the appeal was returned to petitioners. See section 7483; Rule 190. In a letter accompanying the returned document, it was explained to petitioners that an appeal at this time was premature as no decision had yet been entered by the Court in this case. Petitioner, Allen Brunwasser, was advised by telephone on the day before the date of the hearing that the hearing would proceed as scheduled. Petitioners chose not to attend and were not represented at the hearing.

(3rd Cir. 1970); Gulfstream Land & Development Corp. v. Commissioner, 71 T.C. 587 (1979). The burden of demonstrating that there is no genuine issue of material fact is upon the moving party. Adickes v. Kress & Co., 398 U.S. 144, 157 (1970); Graf v. Commissioner, 80 T.C. 944, 946 (1983); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982).

After careful consideration of the record in this case, we find there are no issues of material fact in dispute. Therefore, in accordance with Rule 121(b), we shall proceed with the resolution of the legal issues brought forth in respondent's motion.[5]

We are first asked to determine whether the statute of limitations bars the assessment and collection of a deficiency in petitioners' income tax for taxable year 1977. Petitioners argue that the Form 872 consents to extend the statute of limitations were not valid because petitioners were not specifically informed that the consents covered the alleged mathematical or clerical error adjustment. As a result, petitioners contend the notice of deficiency, on which this case is based, was untimely. We do not agree.

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[5] In a document entitled "Motion to Dismiss and Answer to Respondent's May 1, 1985 Motions and Brief," filed by petitioners on June 12, 1985, certain other issues are raised in response to respondent's motions. A thorough discussion of any relevant issues is found in Brunwasser v. Commissioner, T.C. Memo. 1986-196 (filed May 15, 1986). In the interest of judicial economy, we will not repeat the arguments or the ensuing analysis here, but incorporate our prior opinion by this reference.

Section 6501(a) provides the general rule that the Commissioner has three years after the taxpayer's return is filed within which to commence statutory proceedings for assessment and collection of tax by the mailing of a notice of deficiency. Section 6501(c)(4) allows the normal three year statute of limitations to be extended by agreement between the parties.

Petitioners' income tax return for taxable year 1977 was timely filed on or before April 15, 1978; consequently, the three year statute of limitations under section 6501(a) would have expired on April 15 of the third year after filing this return. Therefore, the statute of limitations would have expired for the taxable year 1977, on April 15, 1981.

Petitioners concede that three consents, Form 872 waivers of the statute of limitations, were executed during the examination of the 1977 return, ultimately extending the statute of limitations to December 31, 1982. Furthermore, respondent has produced three consents executed by petitioners on January 28, 1981, June 26, 1981 and December 28, 1981. The consents extend the statute of limitations to December 31, 1981, March 31, 1982 and December 31, 1982, respectively.

Respondent does not, nor is it necessary to, rely on the second consent executed by petitioners on June 26, 1981. This Form 872 was signed on behalf of the Commissioner, but was not dated. However, the third consent was executed by both parties before the first consent expired on December 31, 1981. See generally, United States v. Havner, 101 F.2d 161 (8th Cir. 1939) and Thiel Service Co. v. Commissioner, 17 B.T.A. 1114 (1929), affd. 50 F.2d 173 (7th Cir. 1931).

When respondent relies on the exception to the running of the statute of limitations provided by section 6501(c)(4), respondent bears the burden of proving the validity of the waivers. Tameling v. Commissioner, 43 F.2d 814 (2nd Cir. 1930); affg. 13 B.T.A. 177 (1928); Bonwit Teller & Co. v. Commissioner, 10 B.T.A. 1300 (1928); Farmers Feed Co. v. Commissioner, 10 B.T.A. 1069 (1928). However, waivers valid on their face and introduced into evidence by respondent shift the burden of going forward to show that the consents are invalid, to the petitioner. Concrete Engineering Co. v. Commissioner, 19 B.T.A. 212 (1930), affd. 58 F.2d 566 (8th Cir. 1932). Petitioners have not shown the invalidity of the consents.

The Form 872 consents in this case are unrestricted on their face.[6] Moreover, nothing in the record indicates that any representations were made to petitioners assuring them that the consents did not cover the alleged mathematical or clerical errors appearing on their 1977 tax return.

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[6] The statute of limitations may be extended for the purpose of making specific adjustments. However, the conditions limiting the adjustments must be clearly expressed on the consent form. Marx v. Commissioner, 179 F.2d 938 (1st Cir. 1950), affg. T.C. Memo. 1949-014, cert. denied 339 U.S. 964 (1950); Associated Mutuals Inc. v. Delaney, 80 F. Supp. 1021 (D. Mass. 1948), affd. 176 F.2d 179 (1st Cir. 1949); and Tallal v. Commissioner, 77 T.C. 1291 (1981), affd. 778 F.2d 275 (5th Cir. 1985).

Petitioners argue rather strenuously that there exists a duty to inform a taxpayer executing a consent of the nature of the adjustments the extension covers. However, petitioners cite no legal authority to back up this contention. As a practical matter, this argument is far afield. In many instances the consents are signed prior to the audit and before a thorough examination of the return has been conducted. This was true in this case where the first consent was executed before the revenue agent completed the audit. It is inconceivable that the Commissioner should be constrained at this early stage by a duty to inform the taxpayer of each and every adjustment covered by the waiver. There is simply no support for a conclusion that the Commissioner had a duty to inform petitioners that the alleged mathematical or clerical errors would be covered in the three consents executed by petitioners.[7]

Therefore, on the basis of the record in this case, we conclude that the first and third consents were timely executed and valid to extend the statute of limitations until December 31, 1982. Therefore, the notice of deficiency, issued to petitioners on April 13, 1982, was timely.

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[7] Petitioners make the argument that there was "implied fraud" when they were not informed that the consent covered the mathematical errors. Silence becomes fraudulent only when there exists a duty to speak. United States v. Prudden, 424 F.2d 1021, 1035 (5th Cir. 1970), cert. denied 400 U.S. 831 (1970).

The second issue we must address is whether there exists a deficiency in petitioners' 1977 Federal income taxes. It is respondent's position that petitioners made two errors in calculating their tax for 1977, resulting in a deficiency of $9,493.40. We agree.

Petitioners used Rate Schedule Y to calculate the tax due on their taxable income of $91,279.83. The correct application of Rate Schedule Y yields a tax of $38,027.90. However, petitioners mistakenly arrived at the figure of $28,238.00. Instead of putting the correct amount of tax due in 1977 on line 4 of Schedule TC they reported $28,238.00. As a result, the final tax liability reported on line 11 of Schedule TC was deficient by $9,789.90.

Petitioners compounded this error by making another miscalculation on Schedule SE in the calculation of social security self-employment tax. In filling out Schedule SE petitioners correctly came up with a figure of $16,500 on line 17. The instructions for the following line, line 18, state that "[i]f line 17 is $16,500, enter $1,303.50 * * *." As previously noted, the figure on line 17 was $16,500, however, petitioners did not place $1,303.50 on line 18. Instead of placing the correct figure on line 18, petitioners entered $1,600.00 on line 18. This mistake meant that petitioners reported $296.50 in excess of the self-employment tax actually required.

The effect of the two errors made by petitioners on their 1977 Federal income tax return was a net understatement of tax equal to $9,493.40. It is clear from the record in this case that petitioners made the errors outlined above. The result of petitioners' errors is a deficiency in tax which petitioners must now pay.

The third issue before us is whether we may adjudicate the rate of interest to be applied to petitioners' deficiency in income tax. Respondent argues that this Court has no jurisdiction over such matters and we agree. The law has long been settled that this Court has no jurisdiction over the computation of the rate of interest to be paid after a deficiency has been determined. *Standard Oil Co. v. McMahon*, 244 F.2d 11 (2d Cir. 1957); *Commissioner v. Kilpatrick's Estate*, 140 F.2d 887 (6th Cir. 1944); *LTV Corp. v. Commissioner*, 64 T.C. 589 (1975).

The last issue we must consider is whether we should award damages to the United States pursuant to section 6673. We follow our decision in *Brunwasser v. Commissioner*, T.C. Memo. 1986-196 (filed May 15 , 1986) in deciding not to award damages to the United States in this case. However, we must reiterate that if petitioners file any further petitions in this Court, based upon arguments wholly unsupportable in the body of Federal tax law, we will award damages to the United States pursuant to section 6673.

An appropriate order
shall be entered.

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UNITED STATES TAX COURT

ALLEN N. BRUNWASSER AND BEVERLY BRUNWASSER, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 34386-84. Filed May 15, 1986.

Allen N. Brunwasser, pro se.

Edward J. Laubach, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DRENNEN, *Judge*: This case was assigned to Special Trial Judge Hu S. Vandervort pursuant to section 7456 and Rules 180 and 181.[1] The Court agrees with and adopts his opinion, which is set forth below.

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. All Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise stated.

OPINION OF THE SPECIAL TRIAL JUDGE

VANDERVORT, Special Trial Judge: This case is before the Court on respondent's Motion for Summary Judgment and To Award Damages Under I.R.C. Section 6673, filed May 16, 1985.[2]

In the notice of deficiency issued to petitioners on July 3, 1984, the Commissioner determined deficiencies in petitioners' Federal income taxes for the taxable years 1980 and 1981 in the amounts of $21,412.91 and $3,141.68, respectively.

The issues raised by respondent's motion are: (1) whether there exists a deficiency in petitioners' Federal income taxes for 1980; (2) whether there exists a deficiency in petitioners' Federal income taxes for 1981; and, (3) whether damages should be awarded to the United States pursuant to section 6673.

Petitioners timely filed their 1980 Federal income tax return on August 24, 1981, having been granted an extension until September 15, 1981 to file such return. On Schedule G, Income

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[2] This docket, No. 34386-84, is one of three dockets pending before the Court involving the same taxpayers and similar issues. All three dockets, No. 27166-82, No. 18193-82 and No. 34386-84, are the subject of substantially similar motions for summary judgment filed by respondent on May 16, 1985.

Respondent previously filed motions for summary judgment in the cases at docket Nos. 18193-82 and 27166-82 on September 17, 1984. The Court conducted a hearing on these motions in Pittsburgh, Pennsylvania before the Honorable Charles E. Clapp, II on November 26, 1984. However, before the conclusion of this hearing Judge Clapp recused himself. The hearing was concluded and respondent's motions were denied without prejudice. On May 16, 1985 respondent filed the motions currently before the Court.

Averaging, petitioners made several mistakes in their addition and subtraction. In computing the Base Year 1978 and the Base Year 1976, petitioners made the following errors:

		Petitioners' Computation	Correct Computation
Base Year 1978	Line 1	$144,705.00	$144,705.00
	-Line 2(a)	2,250.00	- 2,250.00
		$141,455.00	$142,455.00
Base Year 1976	Line 3	$131,568.00	$131,568.00
	+Line 5	3,200.00	3,200.00
		$128,368.00	$134,768.00

In computing the tax on the Schedule G (lines 15-28), petitioners made several more errors which account for a large part of the final erroneous Schedule G calculation. On line 22 petitioners mistakenly inserted $90,683.00 when they should have reported $84,771.00. Thus when they subtracted line 22 ($90,683.00) from line 21 ($90,683.00) petitioners came up with zero on line 23 when it should have been $7,120.00. This result follows because petitioners also incorrectly computed the entry for line 21; the correct entry was $91,891. Next on line 24, when petitioners were instructed to multiply the amount on line 23 by 4, they came up with zero when they should have reported $28,480.00. As a result of these computational errors on Schedule G, petitioners reflected a total tax liability, inclusive of self-employment tax, of $92,780.90, rather than the correct tax, utilizing Schedule G, of $122,468.90 on their Form 1040.

On October 19, 1981, petitioners received a mathematical or clerical error assessment pursuant to sections 6213(b)(1). The assessment was abated on March 21, 1983, after petitioners requested an appeal from the assessment under section 6213(b)(2). Thereafter, an audit of petitioners' 1980 return was conducted.

Petitioners timely filed their 1981 Federal income tax return on September 22, 1982 having been granted an extension to file to October 15, 1982. While filling out their return, petitioners made the following errors. On Form 4726, Maximum Tax on Personal Service Income, petitioners made several mistakes. In determining net income on line 3 they omitted their $7,500.00 Keogh deduction. In addition petitioners incorrectly subtracted the figure on line 18 from the amount on line 17, resulting in the incorrect figure on line 19. (Even if petitioners had not made the subtraction error, their results would have been incorrect due to the omission of the Keogh deduction earlier in the calculation of the maximum tax). On line 20 petitioner reported a final figure of $122,176 as their maximum tax, while the correct computation yields $125,153.04.

Petitioners carried over the incorrect maximum tax of $122,176.00 from Form 4726 to Form 1040, line 35. Several lines down, on line 46, petitioners claimed what they titled a "General Tax Credit" of $180.00. This amount was inserted on line 46 which calls for Total Credits. Total Credits is derived from adding together all the credits listed on lines 38 through 45.

There is no "General Tax Credit" listed on lines 38 through 45, nor did petitioners indicate any authority allowing such a credit.

After subtracting the $180.00 "General Tax Credit" from their reported line 35 tax of $122,176, petitioners arrived at a tax of $121,996.00. To this number they added $2,762.10 of self-employment tax reflected on line 48. However, instead of arriving at $124,758.10 (the correct total of $121,996.00 plus $2,762.10), petitioners reported $124,938.10 on line 54. This figure is $180 more than it should be if added correctly, which leads us to believe that petitioners added back the $180.00 "General Tax Credit" previously taken on line 46. Therefore, petitioners reported total tax of $124,938.10 on line 54 of Form 1040 for 1981.

Because of the above and the initial mistake of carrying over the incorrect tax from line 20 of Form 4726 to line 35 of Form 1040, petitioners' total tax on line 54 of Form 1040 was in error. With all of the calculations done correctly the total tax on line 54 of Form 1040 is $127,915.14 (rather than the $124,938.10 as reported by petitioners). The net result of petitioners' errors is an understatement of tax in the amount of $2,977.04[3].

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[3] Although the return as filed by petitioners for 1981 shows a total tax of $124,938.00, the Commissioner ultimately assessed a smaller amount of tax against the petitioners for 1981.

On July 3, 1984, the Commissioner issued a notice of deficiency to petitioners concerning both the 1980 and 1981 taxable years. The deficiency in 1980 was based on the above errors and petitioners' alleged omission of $381.00 in interest income.[4] The Commissioner recomputed petitioners' tax for 1980 using the maximum tax method rather than income averaging, to come up with a lower tax liability for 1980. The total deficiency determined for 1980 was $21,412.91.

The 1981 deficiency was based upon petitioners' alleged errors, their failure to deduct Keogh plan contributions from their maximum tax computation and the erroneous "General Tax Credit." The notice of deficiency stated a deficiency of $3,141.68.[5] Petitioners filed a timely petition to begin this case. Thereafter, respondent filed the motion which is before us today.

On July 11, 1985, at a special trial session of the Court, in Pittsburgh, Pennsylvania, the parties were given a chance to present oral argument regarding respondent's motion. However, there was no appearance by or on behalf of petitioners.[6]

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[4] Petitioners have not put the $381.00 of interest income in issue, therefore, petitioners are deemed to have conceded this issue. See Rollert Residuary Trust v. Commissioner, 80 T.C. 619, 636 (1983), affd. 752 F.2d 1128 (6th Cir. 1985); Markwardt v. Commissioner, 64 T.C. 989, 997 (1975).

[5] See footnote 3.

[6] Petitioners were notified of the date, place and time of the
(footnote continued)

Rule 121(b) states that a decision on a motion for summary judgment shall be rendered "if the pleadings, * * * and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law."

Thus, in deciding a motion for summary judgment, we must clearly determine that there are no issues of material fact in dispute. Season-All Industries, Inc. v. Turkiye, 425 F.2d 34 (3d Cir. 1970); Gulfstream Land & Development Corp. v. Commissioner, 71 T.C. 587 (1979). The burden of demonstrating that there is no genuine issue of material fact is upon the moving party. Adickes v. Kress & Co., 398 U.S. 144, 157 (1970); Graf v. Commissioner, 80 T.C. 944, 946 (1983); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982).

(footnote continued from previous page)
hearing by an Order of the Court. Petitioners transmitted an appeal to the United States Court of Appeals for the Third Circuit by mailing it to the United States Tax Court in Washington, D.C. Since this was an interlocutory appeal, the appeal was returned to petitioners. See section 7483; Rule 190. In a letter accompanying the returned document, it was explained to petitioners that an appeal at this time was premature as no decision had yet been entered by the Court in this case. Petitioner, Allen Brunwasser, was advised by telephone on the day before the date of the hearing that the hearing would proceed as scheduled. Petitioners chose not to attend and were not represented at the hearing.

After careful consideration of the record in this case, we find there are no issues of material fact in dispute. Therefore, in accordance with Rule 121(b), we shall proceed with the resolution of the legal issues brought forth in respondent's motion.[7]

The first issue for our determination is whether there exists a $21,412.91 deficiency in petitioners' 1980 Federal income taxes. Respondent argues that the deficiency in income tax is a result of numerous errors made by petitioners in filling out their Federal income tax return. We agree.

The first error, on line 1 and line 2(a) of Schedule G, Income Averaging, was a simple mistake in subtraction. Petitioners were $1,000 off when they subtracted line 2(a) ($2,250.00) from line 1 ($144,705.00), arriving at $141,455.00, rather than the correct figure of $142,455. The second error occurred when petitioners failed to follow the instructions on Schedule G which require the addition of lines 3 and 5. Instead, petitioners subtracted the amount listed on line 5 from the amount listed on line 3. Petitioners proceeded to make additional errors on Schedule G when they miscalculated the tax on the amount on line 15 which was to be reported on line 22.

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[7] In a document entitled "Motion to Dismiss and Answer to Respondent's May 1, 1985 Motions and Brief," filed by petitioners on June 12, 1985, certain other issues are raised in response to respondent's motions. A thorough discussion of any relevant issues is found in Brunwasser v. Commissioner, T.C. Memo. 1986-196 (filed May 15, 1986). In the interest of judicial economy, we will not repeat the arguments or the ensuing analysis here, but incorporate our prior opinion by this reference.

As a result of these errors, the remaining calculations on Schedule G were also in error. The final result was that petitioners reported a Schedule G tax on line 28 of $90,683.00 when it should have been $120,371.00. This error continued on to Schedule TC and Form 1040, resulting in petitioners underreporting their income tax liability for 1980 by $29,688.00. However, in the notice of deficiency, respondent calculated petitioners' tax by using the more favorable maximum tax rather than income averaging with the result that petitioners underreported their tax liability by $21,412.91.

The second issue for our determination is whether there is a deficiency of $3,141.68 in petitioners' 1981 Federal income taxes. On Form 4726, Maximum Tax on Personal Service Income, petitioners neglected to include their Keogh deduction. Later, on line 19, they reached an inaccurate result due to incorrect subtraction of line 18 from line 17. The erroneous result on Form 4726 was then carried over to Form 1040 where petitioners made additional errors.

Petitioners claimed what they titled a "General Tax Credit," in the amount of $180.00 on Form 1040. On the 1981 tax return there is no space or line set aside for a "General Tax Credit." Petitioners simply inserted the $180.00 on line 46 of their Form 1040. This line indicates that a taxpayer should insert the total credits allowed for the year. Credits allowed in 1981 are reflected in lines 38 through 45. Petitioners claimed none of these allowable credits, instead claiming a "General Tax Credit of $180.00."

Section 42 authorized a "General Tax Credit" which expired in 1978. However, in 1981, the year before the Court, there was no such authorized tax credit. See section 42, as amended by section 103(c), Tax Reduction and Simplification Act of 1977, 91 Stat. 126, 139. Therefore, we find that no "General Tax Credit" existed in 1981. The net result of the above errors in completing Form 4726 and Form 1040 was a deficiency of $3,141.68.

The last issue we are asked to consider in this motion is whether we should award damages to the United States pursuant to section 6673. We follow our decision in *Brunwasser v. Commissioner*, T.C. Memo. 1986-196 (filed May 15, 1986) in deciding not to award damages to the United States in this case. However, we must reiterate that if petitioners file any further petitions in this Court, based on arguments wholly unsupportable in the body of Federal tax law, we will award damages to the United States pursuant to section 6673.

An appropriate order
shall be entered.

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T. C. Memo. 1986-199

UNITED STATES TAX COURT

RICHARD A. ENGERT, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 40468-84. Filed May 19, 1986.

Richard A. Engert, pro se.

Frank Laurino, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

PARR, Judge: Respondent determined deficiencies in petitioner's Federal income tax liabilities and additions to tax, as follows:

Year	Deficiency	Additions to Tax, I.R.C. 1954 §6651(a)(1)[1]	§6653(a)(1)	§6653(a)(2)[2]
1981	$6,869.00	$814.00	$343.00	50% of the interest due on $3,256.22
1982	6,508.00	- 0 -	325.00	50% of the interest due on $2,650.40

The respondent also requested the imposition of damages under section 6673 in an amount not to exceed $5,000 for commencing and maintaining a frivolous and groundless suit. The issues presented are:

(1) Whether a "vow of poverty" signed by petitioner October 20, 1981 was effective to reduce his taxable income for that year.

(2) Whether petitioner is liable for an addition to tax for failure to file an income tax return for 1981.

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] In his notice of deficiency, respondent determined additions to tax under sec. 6653(a)(2) based on $6,869 and $6,508. After a question raised by petitioner at trial, respondent conceded that the proper amounts should be as shown above.

(3) Whether petitioner is entitled to deduct charitable contributions in the amounts of $21,726.29 for 1981 and $22,313.49 for 1982.

(4) Whether petitioner is liable for additions to tax under section 6653(a)(1) and (2) for negligence or intentional disregard of rules and regulations for 1981 and 1982.

(5) Whether petitioner is liable for damages under section 6673.

Some of the facts have been stipulated and they are so found. When he filed his petition, petitioner resided in Brooklyn, N.Y. During the years in issue he was employed by the New York City Transit Authority as a line supervisor for cars and ships. He was paid wages for his services in the amount of $28,575.20 in 1981 and $29,297.13 in 1982. For convenience, our remaining findings of fact and opinion are combined below.

1981 "Vow of Poverty"[3]

On September 1, 1981 petitioner founded "The Church of Modern Enlightenment," which maintains its office at 484-67th Street, Brooklyn, N.Y., a rented apartment where petitioner resides. On September 16, 1981, petitioner opened a bank account in the name of the "church" (church account) at Manufacturers Hanover Trust. Three church "trustees," petitioner, Phyllis A. Engert, and Sanford I. Kleinman, each had signatory authority over the account. Any one of the three was authorized to write checks. Phyllis A. Engert is petitioner's sister. Sanford I. Kleinman is petitioner's co-worker at the transit authority, and the "minister" of a church similar to petitioner's. (See discussion under "Damages," below.) Petitioner's church had six members: the three trustees and three members of Kleinman's family.

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[3] Terms first appearing in quotation marks are used for convenience only. As will become evident below, we do not intend a finding that they are in substance what they purport to be.

On October 20, 1981,[4] petitioner signed a vow of poverty, witnessed by the trustees. Petitioner purported to irrevocably give all his possessions to the church, whether or not they continued to appear in his personal name. The vow further stated, "Secular employment remuneration (when directed by the Church) is not personal remuneration, but a donation to the Church or Order and not belonging to the individual or the undersigned."

Petitioner's wages were paid to him during the taxable years 1981 and 1982 for services performed for the New York City Transit Authority in his individual capacity. Petitioner's position did not involve any religious duties. The transit authority had no contract or other agreement with any church or religious organization regarding petitioner's services, and the wages were paid directly to petitioner with no restrictions on their use.

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[4] Petitioner contends he is entitled to a charitable deduction for the portion of 1981 not covered by the vow of poverty. The charitable deduction issue is addressed below.

It is a truism in tax law that income is taxed to the one who earns it. Lucas v. Earl, 281 U.S. 111 (1930). See also Helvering v. Horst, 311 U.S. 112 (1940); Helvering v. Eubank, 311 U.S. 122 (1940). Regardless of vows of poverty, when secular services are rendered by an individual, income received by him in his individual capacity and not on behalf of a separate and distinct principal is taxable to the individual. Pollard v. Commissioner, 1086 F.2d 1063 (11th Cir. 1986), affg. a Memorandum Opinion of this Court; McGahen v. Commissioner, 76 T.C. 468 (1981), affd. without published opinion 720 F.2d 664 (3d Cir. 1983); Kelley v. Commissioner, 62 T.C. 131 (1974). Accordingly, we find that the wages paid to petitioner are taxable to him.

Failure to File

Respondent maintains that the Form 1040 submitted by petitioner for the taxable year 1981 was not a return within the meaning of sections 6011(a) and 6651(a)(1). Section 6651(a)(1) provides for an addition to tax if a taxpayer fails to file a timely return unless such failure is due to reasonable cause and not due to willful neglect.

The general requirements of a Federal income tax return are set forth in section 6011(a), which provides in relevant part as follows:

> When required by regulations prescribed by the Secretary any person made liable for any tax * * * shall make a return or statement according to the forms and regulations prescribed by the Secretary. * * * [Emphasis added.]

Here, petitioner filed a blank return, except for his name, address, social security number, filing status, and request for refund of amounts withheld. He signed the return, and attached a copy of his W-2 Form from the New York City Transit Authority. The W-2 showed amounts of wages and withholdings for Federal income tax, FICA tax, and state and local income taxes. Petitioner also attached a typed form in which his name was filled in. The form read, in its entirety:

> Reverend Richard Engert is a member of a Religious Order who has taken an irrevocable Vow of Poverty and performs services pursuant to direction by the Order as an agent. The income generated is the property of the Church and Order and not personal income to the individual.
>
> For confirmation or clarification, you may write to:
>
> Worldwide Religious Order of Almighty God
> Section T1
> 4395 Austin Boulevard
> Island Park, New York 11558[5]

A document constitutes a valid tax return if "it contains sufficient data from which respondent can compute and assess a tax liability." McCaskill v. Commissioner, 77 T.C. 689, 697 (1981), and cases cited therein. Accord, Commissioner v. Lane-Wells Co., 321 U.S. 219 (1944).

The U.S. Supreme Court in the case of Commissioner v. Lane-Wells Co., supra, stated:

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[5] We note that the vow of poverty dated October 20, 1981 and entered into evidence by petitioner designates the Church of Modern Enlightenment and the Order of the Circle of Golden Light to receive petitioner's donation and possessions, not the Worldwide Religious Order of Almighty God.

> Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. It thus implements the system of self-assessment which is so largely the basis of our American scheme of income taxation. The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished. * * * [321 U.S. at 223; emphasis added.]

The Supreme Court test has several elements: (1) There must be sufficient data to calculate tax liabilities; (2) the document must purport to be a return; (3) there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and, (4) the taxpayer must execute the return under penalties of perjury. Beard v. Commissioner, 82 T.C. 766 (1984), on appeal (6th Cir., Sept. 24, 1984), and cases cited therein.

Since petitioner denies that the wages reflected on the W-2 form are his income, and since he did not fill in the Form 1040 as required, he has failed to meet the second and third prongs of the above test.

Moreover, the attachment of a Form W-2 does not substitute for the disclosure on the return itself of information as to income, deductions, credits, and tax liability, and hence the first prong of the above test is not satisfied. Beard v. Commissioner, supra at 779; Reiff v. Commissioner, 77 T.C. 1169 (1981). In fact, the document effectively disguises the Form W-2 information by disclaiming any tax liability whatsoever. See United States v. Rickman, 638 F.2d 182, 184 (10th Cir. 1980). As we said in Reiff v. Commissioner, supra, the acceptance of documents like petitioner's as a return within the meaning of the Internal Revenue Code would disrupt the administration of the tax laws and serve to undermine the integrity of our self-assessment tax system. We hold that petitioner's document does not constitute a return within the meaning of sections 6011(a) and 6651(a)(1).

We further hold that petitioner has not borne his burden of proving that his failure to file a return is due to reasonable cause and not due to willful neglect. Rule 142(a); BJR Corp. v. Commissioner, 67 T.C. 111, 130-131 (1976); Elliott v. Commissioner, 40 T.C. 304, 315 (1963). Even a good faith belief that one is not required to file a return does not constitute cause under section 6651(a)(1) unless bolstered by the timely-sought advice of a competent tax adviser who has been fully informed of all relevant facts. Stevens Bros. Foundation, Inc. v. Commissioner, 39 T.C. 93, 133 (1962), affd. in part and revd. in part 324 F.2d 633 (8th Cir. 1963).[6] Petitioner offered no such evidence. Respondent's determination of an addition to tax under section 6651(a)(1) is upheld.

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[6] See also Norris v. Commissioner, T.C. Memo. 1986-151 and cases cited therein.

Charitable Contributions, 1981-1982

Petitioner reported his wages of $29,297.13 as income in 1982, but deducted $29,101.13 as a charitable contribution.[7] At trial he argued he was also entitled to a charitable contribution deduction in the full amount of his net pay for 1981, in the event the Court should not accept his attempted assignment of income to the Church of Modern Enlightenment for 1981.

At trial, petitioner presented a revised method of calculating his deduction for charitable contributions. As to 1981, petitioner testified he received gross wages of $28,575. After subtracting Federal, state, local, and FICA taxes withheld (as shown on the W-2 Form attached to his return), he received net wages of $21,726.29. After September 16, 1981, when the church checking account was opened, petitioner received net wages of $8,603.50, which he deposited in the church checking account and which he now claims as a donation. He also claims a deduction for the net wages of $13,122.79 he received from January 1 to September 15, 1981 on the theory that it equals or exceeds the value of possessions donated to the church through his vow of poverty. Petitioner presented no evidence of the possessions donated nor of their value.

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[7] Petitioner also deducted union dues of $196. Since this amount did not exceed petitioner's zero bracket amount of $2,300, respondent increased his taxable income $196 to eliminate the itemized deduction, and computed petitioner's tax using the tax table which includes the zero bracket amount of $2,300.

For 1982, petitioner now claims the appropriate deduction should be $22,313.49, which was, again, net wages received.

Petitioner lives in the same apartment where he resided before the purported gift to the church. He uses the same furniture and possessions he previously used. He testified his personal expenses are met with a $600 per month "parsonage allowance" for food, rent, utilities, and other personal expenses, an amount which can be increased by permission of the trustees. While this would only total $7,200 per year, petitioner testified the remainder of his net wages were deposited in a Dreyfus account for a "church building fund" in 1982. Petitioner and Kleinman had signature authority over that fund, which petitioner testified contained $17,000 in 1982.[8] Petitioner was the sole contributer to the church during the years in issue.

Deductions are a matter of legislative grace and the taxpayers must satisfy the specific statutory requirements for the deductions that they claim. New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934). Taxpayers bear the burden of proving their entitlement to those deductions. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a). To secure a deduction for a charitable contribution under section 170(c), petitioner must establish that he has made an unconditional gift to a qualified entity. See Pollard v. Commissioner, 1086 F.2d 1063 (11th Cir. 1986), affg. a Memorandum Opinion of this Court; DeJong v. Commissioner, 309 F.2d 373, 376-379 (9th Cir. 1962), affg. 36 T.C. 896 (1961).

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[8] Petitioner is also a trustee and member of Kleinman's church and shares signature authority over that church bank account as well as his own.

Qualified entities under section 170 include most organizations that qualify for an exemption from tax under section 501(c)(3). Such organizations must be organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international sports competition, or for the prevention of cruelty to children or animals, and no part of the net earnings of the organization may inure to the benefit of any private individual. See 170(c)(2)(B) and (C).

Petitioner has not shown that he made an unconditional gift to a qualified entity in either of the years in issue. Further, the evidence shows that the earnings inured to petitioner's private benefit.

Petitioner continued to reside at his apartment and to use his possessions as he always had. While he shared signatory authority over the church bank account with others, he could and did withdraw funds on his sole signature. The other trustees were a close relative and a co-worker with whom petitioner shared a reciprocal "church trustee" type arrangement. Cancelled checks from the church banking account received in evidence are uniformly for personal expenses such as rent, electric bills, gas, charge accounts, and other personal or living expenses. Many checks are made payable to petitioner himself.[9]

On this record, we sustain respondent in the denial of petitioner's charitable deductions for 1981 and 1982.

Negligence

Petitioner offered no evidence to overcome the presumption of correctness of respondent's determination that he is liable for the additions to tax under section 6653(a). See Davis v. Commissioner, 81 T.C. 806, 820 (1983); Enoch v. Commissioner, 57 T.C. 781, 802 (1972). We therefore sustain respondent's determination of the additions to tax under section 6653(a)(1). We also sustain respondent's determination under section 6653(a)(2).

Damages

The final question is whether damages under section 6673 should be awarded to the government. That section provides that when it appears to the Court that proceedings before it have been instituted or maintained by a taxpayer primarily for delay, or that the taxpayer's position in such proceedings is frivolous or groundless, damages in an amount not in excess of $5,000 shall be awarded to the United States. Petitioner argues that he should not be liable for damages because he cooperated fully with the government by producing all subpoenaed documents and answering all questions asked of him.

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[9] Petitioner explained that the telephone, gas, and electric companies refused to put the accounts in the church's name and denied petitioner's request for a clergyman's discount. He testified this was because he had secular income. We think they accurately saw through petitioner's scheme.

We have noted above petitioner's close relationship with Sanford I. Kleinman. On cross-examination, petitioner acknowledged that he testified in Kleinman's case in this Court, and was present when the Court ruled in favor of respondent on the charitable contribution issue.[10] He further acknowledged that Kleinman's "Good Friendship Temple" is very similar to the "Church of Modern Enlightenment." Petitioner said, "Our ministries coincide, yes." Petitioner, therefore, clearly knew by the time his own case came to trial that his position on that issue was without merit.

We find that petitioner maintained these proceedings primarily for purposes of delay. His positions on the vow of poverty and charitable contribution issues were frivolous and groundless. We recognize that petitioner raised a legitimate issue at trial regarding the computation of the section 6653(a)(2) additions to tax, which caused respondent to modify his original determination as to that issue. However, petitioner could have raised this question with respondent earlier, and avoided a trial on the substantive issues of this case, which were frivolous.

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[10] Kleinman v. Commissioner, docket. No. 16632-84 (unpublished bench opinion Oct. 2, 1985).

On the basis of this record, we conclude that petitioner's position in these proceedings was frivolous and groundless, and that he maintained this suit primarily for delay. Taking all of the factors noted above into account, damages will be awarded to the United States in the amount of $250.

Accordingly, to reflect our holdings,

An appropriate order and
decision will be entered.

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T. C. Memo. 1986-200

UNITED STATES TAX COURT

OLIVE W. GARVEY, Petitioner v. COMMISSIONER OF INTERNAL
REVENUE, Respondent

Docket No. 13712-81. Filed May 19, 1986.

Edmund R. Learned, and Robert A. Page, for the petitioner.

Charles N. Woodward, for the respondent.

MEMORANDUM OPINION

CLAPP, Judge: Respondent determined a deficiency of $748,147.09 in petitioner's 1977 income tax and an addition to

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tax under section 6653(a)[1] in the amount of $37,407.35. After concessions, including a concession by respondent that petitioner is not liable for the negligence addition under section 6653(a), the issue for decision is whether petitioner must include in taxable income for the year 1977 the ordinary income portions of two private annuity contracts that were paid to charitable beneficiaries pursuant to the Garvey Charitable Trust No. Eight (Trust) to which the annuity contracts had been assigned.

This case was submitted under Rule 122. The stipulation of facts and the attached exhibits are incorporated herein by this reference.

On June 1, 1969, petitioner transferred certain properties to Garvey, Inc. (Garvey) in exchange for a private annuity contract (properties annuity). On the same day, Garvey Investments, Inc. (Investments), which was wholly owned by petitioner, also transferred certain properties to Garvey in exchange for a private annuity (investments annuity). On December 9, 1971, Investments was liquidated and all of its rights under the investments annuity were assigned to petitioner.

On April 19, 1976, petitioner created the Trust which terminates on May 31, 1986, a period of 10 years and 42 days. Both annuity contracts were assigned to the Trust. The trust indenture provides that the ordinary income portions of the annuity payments taxable under section 72(a)[2] shall be paid to charitable beneficiaries. The remainder of the annuity payments including that portion excluded under section 72(b) and the section 1231 and ordinary gains portions shall be paid to petitioner.

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[1] All section references are to the Internal Revenue Code of 1954, as in effect during the year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

On March 28, 1980, respondent and petitioner entered into a closing agreement, pursuant to which the tax treatment of the amounts received from the two annuities was agreed upon. For the year 1977, the tax treatment was as follows:

		Excluded	Gains		Ordinary Income
Year	Annuity	Per §72(b)	§ 1231	Ordinary[3]	§ 72(a)
1977	Properties	$633,251.62	$301,127.83	$2,598.40	$892,836.31
1977	Investments	12,413.52	4,200.68	----	19,255.31
		Totals	$953,592.05		$912,091.62

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[2] Sections 72(a) and (b) provide:

> (a) General Rule for Annuities.--Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.
>
> (b) Exclusion Ratio.--Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date). This subsection shall not apply to any amount to which subsection (d)(1) (relating to certain employee annuities) applies.

[3] The parties have used the terms section 72(b), section 1231 gains, and ordinary gains, and we use their terminology solely for convenience.

During 1977, from the payments received under the two private annuity contracts, the trust distributed the following amounts pursuant to the trust indenture:

Charitable Beneficiaries	$912,091.62
Petitioner	$953,592.05

Petitioner agrees that the $953,592.05 is reportable by her in the categories set forth in the closing agreement. However, petitioner argues that the $912,091.62 paid to the charitable beneficiaries should not be included in her gross income and relies entirely on Revenue Ruling 67-70, 1967-1 C.B. 106. In the alternative, petitioner argues that in accordance with section 1.671-3(a)(3), Income Tax Regs., she should be taxable on only a fraction of the $912,091.62 of ordinary income. Respondent contends that petitioner's receipt of a portion of the annuity payments which includes the return of capital and capital gains is a reversionary interest which takes effect in possession or enjoyment within 10 years of the date of transfer to the trust pursuant to section 673(a)[4] and therefore petitioner is treated as the owner of the trust and the income attributable to the reversionary interest is included in computing petitioner's taxable income. We agree with respondent.

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[4] Section 673(a) provides:

> (a) General Rule.--The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if, as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years commencing with the date of the transfer of that portion of the trust.

Section 673(a) provides that the "grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest * * * if * * * the interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years * * *." In the present case, petitioner's receipt of the return of capital and the gains portion of the annuity payments constitutes a reversionary interest within the meaning of section 673(a). Petitioner therefore is treated as the owner of the trust and the income in dispute must be included in the computation of her taxable income. See section 671.[5]

In Rev. Rul. 67-70, the taxpayer-grantor sold property and accepted an installment note providing for monthly payments of principal and interest over a number of years. Taxpayer elected to report gain on the sale on the installment method under section 453. When the note had more than two years to run, taxpayer transferred the note to a trust which would terminate two years and one month after the transfer. Pursuant to the terms of the trust, the taxpayer received the principal payments which included the return of cost basis and the deferred profit and a charitable organization received the interest earned on the note. The primary holding of the ruling was that the transfer to the trust was not a disposition of the installment obligation under section 453(d) which would result in acceleration of the installments and therefore the taxpayer was taxable on the deferred profit as the installment payments were received by the trust. Relying on section 673(b)[6], the ruling held that the taxpayer was not taxable on the interest paid to the charitable organization. Section 673(b) prior to its repeal in 1969, approximately seven years before the transfer to the Garvey Charitable Trust No. Eight, was an exception to the Clifford Trust rules contained in section 673(a). It permitted the transfer of an income interest to a charity for a period of at least two years without requiring the transferor to include the income in his gross income even though he retained a reversionary interest under section 673(a). With the repeal of section 673(b), section 673(a) governs the transfer by petitioner here.

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[5] Section 671 provides--

> Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.

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[6] Prior to its repeal, section 673(b) provided:

> (b) Exception Where Income Is Payable to Charitable Beneficiaries.--Subsection (a) shall not apply to the extent that the income of a portion of a trust in which the grantor has a reversionary interest is, under the terms of the trust, irrevocably payable for a period of at least 2 years (commencing with the date of the transfer) to a designated beneficiary, which beneficiary is of a type described in section 170(b)(1)(A)(i), (ii), or (iii).

Section 673(b) was repealed by section 201(c) of Pub. L. 91-172, 83 Stat. 553, effective as to transfers in trust made after April 22, 1969.

Petitioner's reversionary interest begins to take effect in possession and enjoyment upon the first annuity payment and will continue regularly thereafter until the trust terminates or the annuity payments end, whichever comes first. Rev. Rul. 67-70 is not authority for petitioner's position and her reliance thereon is misplaced.[7]

Petitioner's alternate argument that she should be taxable only on a fraction of the interest is inapposite. Section 1.671-3(a)(3), Income Tax Regs., applies in a situation where a grantor has an undivided fractional interest in a trust or an interest represented by a dollar amount which is a portion of the trust and deals with the computation of that grantor's interest. Here, the record reveals that petitioner, the sole grantor of the trust, is treated as owner of the entire corpus consisting of the two annuity contracts which were the sole assets of the trust. Petitioner gave away the income of the trust for 10 years and 42 days, but retained all the principal and principal payments during the period. At all times petitioner retained the right to income and principal after the 10 year 42 day period. In short, no allocation into portions is required.

Decision will be entered
under Rule 155.

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[7] See Flacco v. Commissioner, T.C. Memo. 1985-393.

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T. C. Memo. 1986-201

UNITED STATES TAX COURT

INDIVIDUAL LIFE ASSURANCE COMPANY, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 24547-84. Filed May 19, 1986.

Norman E. Beal, for the petitioner.

Seymour I. Sherman, for the respondent.

MEMORANDUM OPINION

WILLIAMS, Judge*: The Commissioner determined deficiencies in petitioner's Federal income tax as follows:

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* By order of the Chief Judge, this case was reassigned to Judge Williams for decision and opinion.

Year	Deficiency
1977	$417,958.00
1978	101,546.00
1979	37,410.00

The issues that this Court must decide are

(1) whether petitioner, the reinsuring company in two coinsurance transactions, may deduct amounts paid to or retained by the ceding company as ceding commissions in the year accrued or must amortize such amounts as capital expenditures or deferred expenses over the lives or durations of the transactions; and

(2) whether petitioner must include in income an increase in reserves resulting from a section 818(c)[1] revaluation of reserves.[2]

The facts of this case have been fully stipulated pursuant to Rule 122, Tax Court Rules of Practice and Procedure, and are so found. Petitioner is a Missouri corporation that had its principal place of business in Kansas City, Missouri at the time its petition was filed.

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect in the years here in issue, unless otherwise indicated.

[2] Because we hold for petitioner on these issues, we do not reach a third argued by the parties.

Petitioner's principal business activity is the reinsuring of life insurance risks under policies written by other insurers. Petitioner did not, during the period 1977 through 1980, directly write any policies of life insurance.

When a company issues a policy or contract of permanent life insurance, it must thereafter reflect as a liability, designated by the term "reserve", the excess of the then present value of future benefits payable under the policy over the then present value of future net premiums to be received, computed as applicable state laws or regulations prescribe.[3] The required reserve amount constitutes a liability account against which the company must maintain cash or other assets. The reserve amount reduces the surplus of the company available for other purposes.

During the earliest years of a life insurance policy, the total of reserves required and expenses incurred frequently exceeds the total periodic premiums received. The result for a company experiencing a substantial growth in sales of life insurance policies is a drain on surplus, which could curtail further underwriting.

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[3] Permanent life insurance policies are normally issued on the basis of "level" premiums, which means that the premium charged is based upon the age and insurable status of the insured at the original issue date of the policy, and remains constant. The net valuation portion of the annual premium on a permanent or long-term life insurance policy will normally exceed the true cost of insurance in the earlier policy years, but will thereafter be less than the true cost of insurance. That excess in the earlier years, together with earnings at an assumed rate, develops the policy reserve, which is expected to be available to make up the later inadequacies in the annual net premium and ultimately to pay the policy benefits.

Life insurance reserves may be computed under different methods, including the "net level" method or a "preliminary term" method. Under the "net level" method a new life insurance policy immediately contributes fully to reserves. As first year expenses are typically quite high, this method often causes a rapid surplus drain. The "preliminary term" method of computing reserves, under which life insurance reserves are zero or relatively low in the first year, mitigates the drain on surplus in the early years of a policy and adds slightly greater annual increases to reserves in subsequent years. Over the life expectancy of the insured, the same ultimate reserve is required under either the net level or preliminary term method.

Another means of restoring or generating surplus is to reinsure with another life insurance company all or part of the risks undertaken. Reinsurance transactions may be classified into two categories: (1) assumption reinsurance and (2) coinsurance, which is also known as indemnity reinsurance. This case does not involve assumption reinsurance.[4]

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[4] In assumption reinsurance, one insurance company (the ceding company) transfers some or all of its policies to another company (the assuming or reinsuring company). The assuming company steps into the ceding company's shoes, becoming directly liable to the policyholders and assuming, in respect of the policies transferred, the reserve liability and entitlement to all future premiums. Correlatively, the ceding company is

(footnote continued)

Coinsurance may also be classified into two categories: (1) conventional coinsurance and (2) modified coinsurance ("modco"). In a conventional coinsurance transaction, the ceding company transfers to the reinsuring company all or part of its liability on the reinsured policies but remains directly liable to the policyholders, collects premiums, and pays claims and expenses. The ceding company reduces its reserves attributable to the transferred liabilities, and the reinsuring company increases its reserves to cover the acquired risks. The ceding company also transfers assets agreed to be attributable to the coinsurance transaction to the reinsuring company. The reinsuring company receives an agreed upon premium from the ceding company for assuming the risks but reimburses the ceding company for expenses attributable to the risks reinsured.

A modco transaction differs from a conventional coinsurance transaction in that the ceding company retains the reinsured assets, continues to carry the reserves on its books and collects any investment income derived from assets supporting the reserves. If the parties elect under section 820(a), however, the ceding company's retention of assets and corresponding reflection of reserves is treated for Federal income tax purposes as merely custodial for the reinsuring

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(footnote continued from previous page)
relieved of the reserve liability and, accordingly, reduces its required reserves. *Beneficial Life Insurance Company v. Commissioner*, 79 T.C. 627, 636 (1982).

company. Consequently, for Federal tax purposes, the same transfer of reserves from the ceding to the reinsuring company takes place as in conventional coinsurance.

A conventional coinsurance transaction normally results in a net payment by the ceding company to the reinsurer; a modco transaction normally results in a net payment by the reinsurer to the ceding company. Companies frequently enter into conventional coinsurance and modco transactions simultaneously, thus minimizing the amount or value of cash or other assets being transferred from one company to the other. The reinsurance transactions at issue in this case are a conventional coinsurance and a modco transaction.

Effective 11:59 p.m., December 31, 1980, petitioner, as reinsurer, and Citizen's Insurance Company of America (CICA), as ceding company, entered into a conventional coinsurance agreement and a modco agreement with respect to certain portions of ordinary life risks under a block of insurance policies written by CICA. Petitioner reinsured 31.5642963% of the ordinary life risks under the conventional coinsurance agreement and 58% of such risks under the modco agreement.

CICA had computed its reserves with respect to the block of business reinsured under a preliminary term method. Petitioner properly elected to revalue such reserves under the approximate revaluation method prescribed in section 818(c)(2).[5] With regard to the conventional coinsurance transaction, the initial statutory reserves, the initial cash payment or credit to petitioner, the excess of required reserves over such cash payment or credit (constituting the ceding commission to CICA), the increase in reserves for Federal tax purposes pursuant to the section 818(c)(2) election, and the loss deduction that petitioner claimed in its 1980 return as a result of the transaction were as follows:

Reserves required	$1,150,000.00
Cash to petitioner	230,000.00
Excess (ceding commission)	$ 920,000.00
Section 818(c)(2) Revaluation increase	190,000.00
Loss or deduction claimed	$1,110,000.00

Petitioner paid or credited CICA with a ceding commission of $230,000 in respect of the modco transaction. Petitioner and CICA made a section 820 election to treat the modco transaction, for Federal tax purposes, as a conventional coinsurance transaction, under which CICA's physical retention of the reinsured assets is regarded as merely a custodial retention on petitioner's behalf. The cash payment or credit by petitioner to CICA, the increase in reserves for Federal tax purposes pursuant to the section 818(c)(2) election, and the loss or deduction that petitioner claimed on its 1980 return as a result of the modco transaction, were as follows:

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[5] Section 818(c) was enacted to eliminate any disparity in income tax treatment that would otherwise result from a decision to calculate reserves under a preliminary term or net level method. Without section 818(c), electing the preliminary term method of valuing reserves will result in greater income tax liability in the earliest year of a policy because the required reserves, and consequently the deduction for additions to reserves, will be lower than under the net level method of valuation. In essence, section 818(c) permits a life insurance company using the preliminary term method to recalculate its reserves under the net level method or an approximation method for Federal tax purposes. Beneficial Life Insurance Company v. Commissioner, 79 T.C. at 648-49.

Cash (ceding commission)	$230,000.00
Section 818(c)(2) revaluation increase	349,166.00
Loss or deduction claimed	$579,166.00

The first issue concerns the current deductibility of the ceding commissions that petitioner paid to CICA. This Court addressed the same issue and substantially similar facts in Beneficial Life Insurance Company v. Commissioner, 79 T.C. 627 (1982). In that case we held that ceding commissions paid by the reinsuring company in a coinsurance transaction are currently deductible. 79 T.C. at 646. Respondent asks us to overrule our decision in Beneficial Life. We decline to do so and adhere to our analysis in that case.[6]

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[6] We recently reached the same conclusion on similar facts in Modern Security Life Insurance Company v. Commissioner, T.C. Memo. 1985-629. In that case we held that allowances paid to the ceding company by the reinsuring company in a modco transaction are analogous to currently deductible underwriting expenses to the reinsuring company and that the reinsuring (footnote continued)

The second issue is whether petitioner must include in income its reserves as revalued pursuant to its section 818(c)(2) election. Beneficial Life also controls here. See also Reserve Life Insurance Co. v. United States, 640 F.2d 368, 377 (Ct. Cl. 1981); Security Beneficial Life Insurance Co. v. United States, 517 F. Supp. 740, 770-72 (D. Kan. 1980), affd. 726 F.2d 1491 (10th Cir. 1984). We decline respondent's invitation to overrule Beneficial Life.

To reflect certain concessions,

Decision will be
entered under Rule 155.

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company was therefore entitled to subtract from income any consideration returned to the ceding company in respect of reinsurance ceded.

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T. C. Memo. 1986-202

UNITED STATES TAX COURT

RAYMOND McKAY and BARBARA McKAY, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 17431-84. Filed May 20, 1986.

James C. Neil, for the petitioners.

Carolyn Bechman and Thomas D. Coker, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, Judge: Respondent determined deficiencies of $5,089 and $7,187 in petitioners' Federal income taxes for 1979 and 1980, respectively. The issues to be determined are (1) whether petitioners were in the lumber business during the years in issue and thus entitled to business deductions and investment tax credit in relation to that activity and (2) whether petitioners are entitled to deductions relating to rental property.

FINDINGS OF FACT

Some of the facts have been stipulated, and the stipulation of facts is incorporated herein by this reference. Petitioners were residents of Placerville, California, at the time they filed their petition herein.

In or about February 1976, petitioners purchased for speculation approximately 20 acres of land located in Placerville, California (the Placerville property). The property was covered with large pine trees, ranging in diameter from three to four and one half feet and standing 150 feet tall. In 1978, petitioners paid $6,207.97 for the installation of a well on the Placerville property. In July and September 1979, petitioners made payments of $4,000 and $2,510, respectively, for placing and finishing 864 square feet of concrete on the Placerville property. On or about October 8, 1979, Raymond McKay (petitioner) entered into a contract with Alvin Cheever (Cheever), in which Cheever agreed to clear 16 acres of the

Placerville property at $50 per acre, with a provision for a $250 "incentive fee to be paid later providing 90 acre job on adjoining property is not obtained." Petitioners paid $1,700 to Cheever during 1979. During 1979, petitioners paid $37 for electricity used on the Placerville property. On December 20, 1979, petitioners purchased a Caterpillar tractor/bulldozer for $10,545.

During 1980, petitioners paid $45.25 for electricity service and $191.87 for telephone service at the Placerville property. In March, April, May, and June 1980, petitioners made four payments totaling $10,195 for a fence around the 20 acres of the Placerville property.

In 1981, petitioners moved to Placerville from Van Nuys, California, and constructed a residence on the Placerville property. The only other building on the property is a barn completed in 1984 on the concrete slab placed there in 1979.

During 1979 and 1980, petitioners made incidental sales of firewood cut on the Placerville property. They reported income from sales of firewood totaling $1,290 in 1979 and $885 in 1980. Those sales were reported on Schedules C of their tax returns as gross receipts from lumber sales. On the same Schedules C, petitioners deducted $10,000.14 in 1979 and $17,376 in 1980 as expenses relating to lumber sales. They also claimed investment tax credit on "transportation equipment," the tractor, and the fence. In the statutory notice of deficiency, respondent allowed expenses claimed for interest and taxes and disallowed all other expenses claimed on Schedules C and the investment tax credit on the grounds that petitioners did not establish that their lumber sales activity constituted a bona fide business venture entered into for profit or that the claimed expenses were incurred, or if incurred, paid during the years in issue for ordinary and necessary business purposes.

Petitioners and their representatives met with an Appeals Officer of respondent in 1985. Petitioners were asked questions concerning the purported lumber sales business, and petitioners' representatives, without objection by petitioners, stated that the business involved cutting down trees and selling them for firewood.

In August 1978, petitioners purchased residential property in San Bernardino, California (the San Bernardino property). Petitioners immediately notified the tenant of the property of their intention to raise the rent. In October 1978, the property was declared a public nuisance by the City of San Bernardino. During 1979, petitioners renovated the San Bernardino property in anticipation of renting it to others. The San Bernardino property was not, however, rented during 1979. In September 1979, petitioners paid $65 for insurance on the San Bernardino property. During 1979, petitioners paid $114.67 for utilities on the San Bernardino property.

On their tax return for 1979, petitioners claimed rental losses in relation to the San Bernardino property in the amount of $2,819. Of that $639 was shown as "repairs." Ten thousand dollars was listed as "remodeling" and depreciated for the last 6 months of 1979. Respondent allowed amounts representing interest and taxes but disallowed the balance on the ground that it had not been established that the amounts were incurred or, if incurred, were paid for ordinary and necessary business purposes.

Other adjustments in the statutory notice of deficiency have now been resolved by stipulation of the parties.

ULTIMATE FINDINGS OF FACT

Petitioners did not engage in a lumber sales business during 1979 or 1980 on the Placerville property with an actual and honest profit objective. They engaged in incidental sales of firewood during those years and incurred expenses relating to that activity of $250 in 1979 and $175 in 1980.

During 1979, petitioners incurred rental expenses in relation to the San Bernardino property and are entitled to a deduction in the amount of $280, not including interest and taxes previously allowed by respondent, in relation to that rental activity.

OPINION

Petitioners have the burden of proving that respondent's determination is incorrect and that they are entitled to the deductions that they claim. New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934); Rockwell v. Commissioner, 512 F.2d 882 (9th Cir. 1975); Rule 142(a), Tax Court Rules of Practice and Procedure.

Petitioners claim that they are entitled to various deductions (and investment tax credits on equipment) in relation to (1) a purported lumber sales activity conducted on the Placerville property in late 1979 and early 1980 and (2) a rental activity with respect to the San Bernardino property in 1979. Their right to the deductions and credits depends on their showing that their activities either constituted a trade or business or were for the management, conservation, or maintenance of property held for the production of income. Sections 162(a),[1] 167(a), 212(2); see sections 38 and 48(a)(1). To qualify for deductions under these sections, the taxpayer must have engaged in the activity with an actual and honest profit objective. See Dreicer v. Commissioner, 78 T.C. 642, 646 (1982), affd. without opinion 702 F.2d 1205 (D.C. Cir. 1983); Jasionowski v. Commissioner, 66 T.C. 312, 319-324 (1976). No deduction generally is allowed for personal, living, or family expenses, or for capital expenditures. Sections 262 and 263.

Profit objective is a question of fact to be determined from all the facts and circumstances, and greater weight is to be given to the objective facts than to a mere declaration of the taxpayer's intent. Section 1.183-2(a), Income Tax Regs.; Engdahl v. Commissioner, 72 T.C. 659, 666 (1979). Sec. 1.183-2(b), Income Tax Regs., lists some of the factors to be considered in determining whether an activity is engaged in for profit. The factors listed in the regulation are as follows: (1) Manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) expectation that assets used in activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

Activity on the Placerville Property

Petitioners claim that their activity on the Placerville property during 1979 and 1980 related to a lumber business conducted with a profit motive. They testified that they did not decide to move their residence to Placerville until December 1980. Respondent contends that the activity consisted of land clearing and other conduct preparatory to petitioners' move to Placerville and construction of a residence on the property. Our resolution of this issue depends on the persuasiveness of petitioners' testimony. They did not produce any other witnesses corroborating their statements, and the documentary evidence that they produced was sparse, disorganized, and unhelpful. Because their testimony was vague, inconsistent and improbable, we conclude that it is not adequate to satisfy their burden of proof with respect to the activity conducted on the Placerville property.

Both petitioners testified that they originally purchased the Placerville property for speculation. The well built in 1978 and the concrete slab built in 1979 were expected to substantially increase the value of the property. Mr. McKay conceded that clearing the land was also expected to approximately double the value of the land. Mr. McKay also testified that the purpose of putting a fence around the total perimeter of the property in 1980 was to protect the property after an employee attempted to steal the Caterpillar tractor/bulldozer. Petitioner now contends that all of these capital improvements are the subject of depreciation for part of 1979 and all of 1980 on the ground that petitioners were engaged in a lumber sales activity over that period.

Mr. McKay's testimony is in essence as follows: He was trained as an engineer and employed by various aerospace companies from 1954 until 1971, when he became a consulting engineer. After 1971, he experienced regular occurrences of unemployment. During a period of unemployment commencing in or about August 1979, he remodeled the San Bernardino property for rental purposes and initiated a lumber business in Placerville. He first became interested in the lumber business when talking to an unidentified individual in Placerville who was in the lumber business. He discussed the lumber business with Forestry

Department personnel, log-haulers, and timberworkers. He concluded that the timber market was lucrative and that he could make money from the sale of pine trees from the Placerville property. He commenced business by contracting with Cheever and purchasing a bulldozer to be used by Cheever to knock down trees. After the trees were cut down, he went to sawmills to find out whether they could be sold. At that point in time, February or March 1980, he was told that the trees were diseased and could not be sold. Thereafter he started cutting up oak wood and selling it for firewood.

The first inconsistency between Mr. McKay's explanation and other evidence is that the contract with Cheever was for clearing land, not for harvesting timber, and the work was done 2 months prior to the purchase of the bulldozer. Second, he claims that the concrete slab and the well were assets of the lumber business, although they were constructed prior to the alleged commencement of the business and have not been shown to have been used in any manner in the business. Third, the fence around the full 20 acres, which allegedly was purchased to protect the business assets, was acquired after discovery that the trees were diseased and could not be sold. Fourth, checks offered in purported substantiation of the lumber business expenses for labor, gasoline, and other supplies, were either marked "clearing property" or were dated in early 1979 and November and December 1980. Fifth, Mr. McKay's description of the purported lumber activity is a substantial enhancement on the explanation given to respondent's agent during an appeals conference in 1985 by petitioners' agent in petitioners' presence. All of this evidence reflects adversely on the credibility of Mr. McKay. We do not, therefore, make any findings of fact based on his questionable testimony.

Mrs. McKay's testimony was vague and characterized by statements such as "I believe so," "it looks like," "it could be," and "I guess." She contended that all telephone expenses for calls between Placerville and their family residence in Southern California were business expenses. She did not provide any description of specific activities conducted on the Placerville property that could justify the conclusion that a business was conducted there. She merely asserted in general terms that all of the expenses deducted on the tax returns related to "the business."

Overall, petitioners' explanation of the purported lumber sales business is improbable. There is no indication of the dollar volume of sales that they supposedly anticipated, and there is certainly no evidence that would justify the expenditure of thousands of dollars for machinery and capital improvements in anticipation of a profit from the lumber business. The receipts and canceled checks offered in substantiation of the expenses are incomplete and do not add up to the amounts claimed on the tax returns, even if we ignore doubts as to the purpose of the payments. No complete books and records were kept, and the activity otherwise was not carried on in a businesslike manner.

Notwithstanding his claim that he consulted with various persons involved in the timber business, Mr. McKay demonstrated lack of expertise in failing to make a determination of the feasibility of the sale of timber from his property -- such as a preliminary investigation that would have disclosed whether the trees were diseased. The activity was a part-time effort during periods of unemployment and interrupted by work on other properties. In the context of this case, it is more reasonable to conclude that the capital improvements were intended to prepare the property for other activities, such as the ultimate establishment of petitioners' residence in Placerville. Such expenditures do not establish that the property was held for the production of income in the absence of any evidence that income was anticipated or likely as a result of the activities.

Mr. McKay testified that the sale of firewood was merely an incidental activity "that was not my business." Thus he has somewhat undermined an alternative claim that some of the expenses can be deducted against the income from sale of firewood reported on his returns for 1979 and 1980. We have carefully reviewed the canceled checks and receipts submitted by petitioners and their testimony and are unable to identify any expenses that clearly related to the firewood sales other than $11.80 paid in 1980 for advertising. Nonetheless, some expenses were incurred in relation to sales of firewood, such as equipment rental, supplies, and vehicle operating expenses incurred in transporting the firewood. Using our best judgment and bearing heavily against the taxpayers because the inexactitude is of their own making, we conclude that they are entitled to deduct $250 in 1979 and $175 in 1980 as expenses relating to the sale of firewood. See section 183(b); Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930).

San Bernardino Property

Petitioners testified that during 1979 they were preparing the San Bernardino property for rent and that the availability of the property for rent was made known by "word of mouth." Petitioners had other rental properties during the years in issue, and their testimony as to intent is not contradicted by other evidence.

Section 212(2) allows a deduction for ordinary and necessary expenses paid or incurred for the management, conservation, or maintenance of property held for the production of income. The failure to receive income from the property during the year in issue does not preclude deductibility. Section 1.212-1(b), Income Tax Regs., provides that "income" as used in section 212 includes income to be realized in subsequent taxable years. See Hoopengarner v. Commissioner, 80 T.C. 538, 541-542 (1983), affd. 745 F.2d 66 (9th Cir. 1984); Johnson v. Commissioner, 83 T.C. 103, 119 (1984), on appeal (6th Cir., Apr. 4, 1985, for petitioner, July 8, 1985, for respondent).

Capital expenses, however, cannot be deducted currently under section 212. Sections 1.212-1(n) and 1.263(a)-1, Income

Tax Regs. Such capital assets must be depreciated commencing in the year in which they are placed in service, i.e., ready and available for the intended function,[2] and the taxpayers must establish the basis and useful life of the assets in order to be entitled to deductions for depreciation. Section 167(a); section 1.167(a)-1(a), 1(b), 10(b) and 11(e)(1)(i), Income Tax Regs. Petitioners have failed to prove any of these prerequisites to a depreciation allowance. Mrs. McKay testified that the remodeling was "close enough to being done" in June or July 1979. Canceled checks and receipts offered to prove expenses relating to the property include substantial payments for painting, drywall, and construction materials in July and August 1979, and a contract for installation of carpet is dated September 1979. Entries on her calendar in evidence reflect work being done as late as December 21 and December 22, 1979. Consequently, we are unpersuaded by Mrs. McKay's testimony as to when the property was ready and available for rent.

Petitioners have substantiated $114.67 for utilities and insurance expense in the amount of $65 incurred in relation to the San Bernardino property in 1979. In support of a "mileage" deduction of $578, they have presented calendars on which mileage for various trips, including trips to San Bernardino, is recorded. It appears, however, that the mileage recorded on the calendars includes travel from their residence to areas other than San Bernardino, such as Victorville. Entries on the calendars include references to a separate property in San Bernardino as to which no evidence was offered, but $1,196 was deducted on their tax return as "mileage" relating to the other property. Otherwise petitioners have presented a disorganized group of canceled checks and receipts, some dated 1978, that, for the most part, could substantiate either capital remodeling expenditures or deductible repairs expenses but are not identifiable as one or the other. For example, checks were written to Horace Train for $300 dated July 6, 1979, labeled "repair"; $854 dated July 25, labeled "siding"; $503.32 dated August 7, labeled "labor"; $250 dated August 19, labeled "work"; and $315 dated December 21, labeled "repairs." Again using our best judgment to approximate the amount of deductible expenses, and bearing heavily against petitioners because of their failure to keep accurate records or to establish amounts falling into deductible categories and nondeductible capital expenditures, we conclude that petitioners are entitled to deduct $100 for ordinary and necessary expenses in addition to the amounts substantiated for utilities and insurance, excluding the amounts previously allowed by respondent for interest and taxes.

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[2] See Clemente, Inc. v. Commissioner, T.C. Memo. 1985-367, with respect to buildings in a dilapidated condition, requiring extensive repairs before they can be rented.

Moreover, the taxpayer must capitalize expenditures that would otherwise be currently deductible repairs incurred as part of a plan of renovation or remodeling. See Bloomfield Steamship v. Commissioner, 33 T.C. 75, 84 (1959), affd. per curiam 285 F.2d 431 (5th Cir. 1961); California Casket Co. v. Commissioner, 19 T.C. 32, 38 (1952); Moss v. Commissioner, T.C. Memo. 1986-128.

We have considered the other arguments of the parties and are not persuaded by them.

Decision will be entered under Rule 155.

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T. C. Memo. 1986-203

UNITED STATES TAX COURT

PAUL P. DORAMAN and ETHEL M. DORAMAN, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 23503-83. Filed May 20, 1986.

Paul P. Doraman, pro se.

Cheryl Choy-Weller, for the respondent.

MEMORANDUM OPINION

PARR, Judge: Respondent determined deficiencies in petitioners' Federal income tax liabilities and additions to tax against petitioner Paul P. Doraman, as follows:

Year	Deficiencies	Additions to Tax I.R.C. Section 6653(b)[1]
1973	$3,535.59	$4,045.40
1974	3,502.71	1,751.36
1975	3,631.04	3,334.20

After concessions, the issue remaining for decision is the proper computation of the addition to tax for fraud under section 6653(b).

This case was submitted without trial pursuant to Rule 122, Tax Court Rules of Practice and Procedure. The facts have been stipulated and are so found.

At the time of filing the petition in this case, petitioners resided in Goshen, N.Y.

Petitioners filed their 1973 Federal income tax return on April 28, 1975. No extension had been granted by respondent regarding the filing of this return, and it was not filed timely. The amount shown on the return as total income taxes due was $4,555.21. Payments consisting of income taxes withheld, estimated tax payments, and excess FICA tax withheld totalled $5,748.04. A refund of $1,192.83 was claimed on the return and credited on petitioners' estimated tax for 1974 as directed by petitioners.

Petitioners timely filed their income tax return for the year 1974. The amount shown as income taxes due was $4,720.88. Income taxes withheld, estimated tax payments, and excess FICA tax withheld totalled $6,620.28, resulting in a refund of $1,899.40 which was again credited on petitioners' estimated tax for 1975 pursuant to their instructions.

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years at issue.

Petitioners' 1975 Federal income tax return was filed late, on April 24, 1976, without any extensions having been granted. The amount shown on the return as income taxes due was $3,178.40. Income taxes withheld, estimated tax payments, and excess FICA tax withheld totalled $5,337.23.[2] Pursuant to petitioners' instructions on the return, $158.33 of the refund due was paid to them, and the remaining $2,000 was credited on their estimated tax for the next taxable year.

Respondent determined that the correct tax liabilities of petitioners for the years at issue were $8,090.80 for 1973, $8,223.59 for 1974, and $6,668.40 for 1975. Respondent further determined that at least part of the underpayment of tax was due to fraud on the part of Mr. Doraman ("petitioner") and, as to him alone, determined additions to tax for fraud under section 6653(b).

Petitioner concedes that the deficiencies determined by respondent are correct, and that part of the underpayments were due to fraud. He also concedes that the statute of limitations does not bar the assessment and collection of the deficiencies in tax and additions to tax, and that his income tax returns for the years 1973 and 1975 were not filed timely.[3] He takes exception, however, to respondent's method of computing the fraud addition.

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[2] The total payments of $5,337.23 reported on petitioners' 1975 income tax return reflected estimated tax payments of $820.70. There is no explanation for the discrepancy between this figure and the $1,899.40 claimed refund from 1974 which petitioners requested credited on their 1975 return.

Respondent calculated the fraud addition as follows:

	1973	1974	1975
Total corrected income tax liability	$8,090.80	$8,223.59	$6,668.40
Less total tax shown on return	-	4,720.88	-
Underpayment of tax	$8,090.80	$3,502.71	$6,668.40
50% of underpayment	$4,045.40	$1,751.36	$3,334.20

Petitioner proposes an alternative method of computation which takes into account his withholding and estimated tax payments, as follows:

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[3] Petitioner raised the statute of limitations issue in his petition. In his reply, he denied respondent's allegation that he had filed his 1973 and 1975 returns late. At trial, petitioner raised neither of these issues and agreed with respondent that calculation of the fraud addition was the only issue for decision. We therefore deem those issues conceded by petitioner. With regard to the statute of limitations issue, however, we note that under sec. 6501(c)(1), the Commissioner has an unlimited time period in which to assess and collect taxes due where a taxpayer's return is fraudulent. Where a joint return is filed, but only one spouse is liable for the fraud, sec. 6501(c)(1) nevertheless lifts the normal statute of limitations as to the deficiency due from both spouses. Ballard v. Commissioner, 740 F.2d 659 (8th Cir. 1984), affg. on this issue a Memorandum Opinion of this Court; Vannaman v. Commissioner, 54 T.C. 1011 (1970).

	1973	1974	1975
Corrected income tax liability	$8,090.80	$8,223.59	$6,668.40
Less withholding and estimated tax payments[4]	5,748.04	5,427.45	4,516.53
Additional taxes due	$2,342.76	$2,796.14	$2,151.87
50% of underpayment	$1,171.38	$1,398.07	$1,075.94

Petitioner's method is incorrect under the statute. Respondent properly computed the fraud addition as set forth in section 6653(b). In pertinent part, that section provides as follows:

> (1) In General.--If any part of an underpayment (as defined in subsection (c)) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment.

Section 6653(c) defined "underpayment" of tax. In pertinent part, it reads:

> (1) Income, Estate, Gift, and Certain Excise Taxes.--In the case of a tax to which section 6211 * * * is applicable, a deficiency as defined in that section (except that, for this purpose, the tax shown on a return referred to in section 6211(a)(1)(A) shall be taken into account only if such return was filed on or before the last day prescribed for the filing of such return, determined with regard to any extension of time for such filing), * * *

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[4] The amount of payments claimed by petitioner in this computation for 1973 includes estimated tax payments of $149.88 which were credited from his 1972 return. Petitioner's calculation for 1974 and 1975, however, disregards the credit from the prior year's claimed refund, and includes only actual calendar year withholdings.

Section 6211, to which section 6653(c)(1) refers, defines a deficiency, generally, as the amount by which the tax due exceeds the amount shown as tax on the taxpayer's return plus any amounts previously assessed (or collected without assessment) as a deficiency.

The statute thus provides for computing the fraud addition in the manner followed by respondent. The addition is 50 percent of the underpayment. Sec. 6653(b)(1). The underpayment is the tax required to be shown on petitioner's returns (in this case, $8,090.80 for 1973, $8,223.59 for 1974, and $6,668.40 for 1975), less the amount actually shown as tax on the returns. Sec. 6211(a)(1). The latter amount would be $4,555.21, $4,720.88, and $3,037.36 for 1973, 1974, and 1975, respectively. However, because petitioner's 1973 and 1975 returns were filed late, for those years the amounts shown as tax on his returns are not taken into account. Sec. 6653(c)(1). The fraud addition is thus 50 percent of $8,090.80 for 1973; 50 percent of $3,502.71 ($8,223.59 minus $4,720.88) for 1974; and 50 percent of $6,668.40 for 1975. Respondent's calculations are correct.

A number of cases have dealt with the computation of the fraud addition, and have made clear that where a return is filed late, the underpayment on which the addition is computed is the total corrected tax liability, without any reduction for the tax shown on the late return. See *Cirillo v. Commissioner*, 314 F.2d 478 (3d Cir. 1963), affg. as to this issue a Memorandum Opinion of this Court; *Stewart v. Commissioner*, 66 T.C. 54 (1976); *Breman*

v. Commissioner, 66 T.C. 61 (1976); Bennett v. Commissioner, 30 T.C. 114 (1958); Prejean v. Commissioner, T.C. Memo. 1983-31; Baylor v. Commissioner, T.C. Memo. 1977-253.

It is also clear that a taxpayer's withholding and estimated tax payments are not taken into account in determining the amount of tax due or the amount of tax shown on the return. Sec. 6211(b). Such amounts are thus not considered in computing the fraud addition. Secs. 6653(b)(1) and (c)(1); Cirillo v. Commissioner, supra at 484; Tomlinson v. Lefkowitz, 334 F.2d 262, 267 (5th Cir. 1964), cert. denied 379 U.S. 962 (1964).

We therefore reject petitioner's computation of the fraud addition in favor of respondent's. Accordingly,

Decision will be
entered for respondent.

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T. C. Memo. 1986-204

UNITED STATES TAX COURT

IVAN MAXIMILIAN NEUBAUER II AND MARIJA-TEREZIJA NEUBAUER, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 17295-84. Filed May 20, 1986.

Ivan Maximilian Neubauer II, pro se.

Julia A. Caroff, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

PARR, Judge: Respondent determined a deficiency in petitioners' 1980 Federal income tax in the amount of $528. The issues for decision are: (1) whether $1,673 in travel expenses are deductible by petitioners, (2) whether an additional $507 in

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travel expenses is deductible by petitioners,[1] and (3) whether $2,486 of expenses incurred in connection with Yugoslavian real property and improvements are deductible by petitioners.[2]

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation and attached exhibits are incorporated herein.

At the time they filed the petition herein, petitioners, Ivan M. Neubauer, II and Marija T. Neubauer, husband and wife, resided at 85 Bellarmine Dr., Rochester, Mich. They timely filed their 1980 joint Federal income tax return for 1980 with the Cincinnati Internal Revenue Service Center, using the cash method of accounting for that year.

During 1980, Ivan was an engineer employed by the Ford Motor Company. Maria was then a nurse assistant at Crittenton Hospital. Ivan also received some 1980 compensation as a soccer referee, and Marija distributed telephone directories for the

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[1] This $507 deduction, not claimed on any tax return or amended return, or in the petition, is contended for on brief for the first time. Although some Yugoslavian train tickets, apparently a component of this claim, are in the record, we are afforded no itemization of which expenses comprise this $507.

[2] Petitioners claim in their petition and on a Form 1040X amended income tax return an $800 overpayment resulting from recomputations due to a net operating loss (NOL) in the amount of $2,486. Although not mentioned in the notice of deficiency, respondent contests the relevant deductions on brief. They are itemized in petitioners' amended tax return as follows: $2,161 depreciation; $450 general repairs; $40 insurance; $1 postage. Petitioners reported $166 of income from the property.

Reuben H. Donnelly Corporation. The income from each of the latter two activities was reported on separate Schedule C's attached to petitioners' tax return.

The schedule upon which Maria's income was reported recites the name American Enterprise International (AEI)[3] as the business to which it relates, naming "business development" as AEI's main business activity and "product distribution" as its product. The only income on the schedule is $50 from Maria's distribution of telephone books. No income was reported from the sale of Amway products. Petitioners claimed deductions of $2,088. Of $1,813 claimed for travel and entertainment, respondent disallowed $1,673[4] related to a summertime trip to Yugoslavia.[5]

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[3] Petitioners filed for AEI a Certificate of Persons Doing Business Under an Assumed Name with the Michigan authorities.

[4] The disallowed expenses, stipulated as having been incurred by petitioners, follow:

Ivan's limousine to airport, 6/27/80	$ 11.85
two roundtrip airline tickets to Frankfurt, Germany	1,096.00
Marija's car rental	330.00
gasoline	76.90
mileage charges	73.25
Ivan's train ticket to Frankfurt	85.00
Total	$1,673.00

[5] Respondent's reasons for allowing the balance of the travel and entertainment expenses, presumably related to the same businesses as the disallowed expenses, do not appear of record. We note the possible inconsistent position, however, as to the existence of a business.

Business and Employment Abroad

On December 18, 1979, the Industry for Motor Vehicles Novo Mesto in Yugoslavia wrote Ivan regarding "[y]our valued offer for employment," conditioning such employment on an interview. Ivan was then a Ford Motor Company engineer.

On Friday, June 20, 1980, Marija and her three children flew to Germany, then drove through Austria, where Marija was born, to Yugoslavia. Marija had not been to Austria or Yugoslavia since 1968. Because of a differing vacation schedule, Ivan left for Europe on June 27, 1980. The record is silent as to his prior trips, if any. Each of their flights involved a scheduled stop in New York both east and west bound.

Taking petitioners' evidence at face value, we piece together Marija's activities in Europe as follows:[6]

Fri.	June 20	Travel to Yugoslavia
Sat.	June 21	Arrive in Frankfurt, Germany. Rent car
Sun.	June 22	No business[7]
Mon.	June 23	Amway presented to Fini & Franc Hlebcar and 5 associates in Austria
Tues.	June 24	Second Amway presentation to Hlebcars; Crossed Yugoslav border

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[6] The itinerary is taken largely from a copy of Marija's personal diary. The original was lost while she was making copies.

[7] For itinerary purposes, we deem no business to have been done on days so indicated in the diaries, on days for which there are no diary entries and on days for which the diaries detail no Amway, import/export or job seeking activities.

Wed.	June 25	No business; Go back to Austria
Thurs.	June 26	Amway presented to Hans & Ridi Sauer and 4 associates in Austria
Fri.	June 27	Second Amway presentation to Sauers
Sat.	June 28	Return to Yugosalvia. Return car. Discuss business financing with Ljubljana bank
Sun.	June 29	No business
Mon.	June 30	Further discuss financing with Ljubjana bank
Tues.	July 1	With Ivan discussing auto part import/export business
Wed.	July 2	No business
Thurs.	July 3	More import-export discussions
Fri.	July 4	No business
Sat.	July 5	No business
Sun.	July 6	No business
Mon.	July 7	Amway presentation to Sagadin Valentin in Stuttgart, Germany
Tues.	July 8	Amway presentation to Sagadin Valentin in Sestrze, Yugoslavia, at his vacation home
Wed.	July 9	No business
Thurs.	July 10	Motorcycle/moped franchise negotiations with Tomas, Koper
Fri.	July 11	More Tomas negotiations
Sat.	July 12	No business
Sun.	July 13	No business
Mon.	July 14	With Ivan to Agrostroj in Ljubljana to discuss aluminum irrigation pipe deal

Tues.	July 15	Amway presentation to Josef and Stefka Korosec (vacationing in Sestrze from West Germany)
Wed.	July 16	Further Amway presentation to Korosecs
Thurs.	July 17	No business
Fri.	July 18	No business
Sat.	July 19	Travel to U.S.
Sun.	July 20	Travel to U.S.

Taking petitioners' evidence at face value, we piece together Ivan's activities in Europe as follows:[8]

Fri.	June 27	Travel to Yugoslavia
Sat.	June 28	Travel to Yugoslavia
Sun.	June 29	Travel to Yugoslavia
Mon.	June 30	At Inter County Collective for Employment
Tues.	July 1	At TAM (Maribor Factory for Automobiles and Engines) to discuss auto parts import/export
Wed.	July 2	No business
Thurs.	July 3	At Slavenian Emigrant Society, Chamber of Commerce, Agrostroj, and Employment Service. Applied for engineering related position.
Fri.	July 4	No business

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[8] The itinerary is taken largely from a translation of a copy of Ivan's personal diary. Marija lost the original when she was making copies. Moreover, although Ivan testified that he only helped a Yugoslavian translator, he signed the translation as the translator.

Sat.	July 5	No business
Sun.	July 6	No business
Mon.	July 7	Amway presentation to Sagadin Valentin in Stuttgart, Germany
Tues.	July 8	Amway presentation to Sagadin Valentin in Sestrze, Yugoslavia, at his vacation home
Wed.	July 9	No business
Thurs.	July 10	Outboard/moped franchise negotiations with Tomos, Kopor
Fri.	July 11	Outboard/moped franchise negotiations with Tomos, Kopor
Sat.	July 12	No business
Sun.	July 13	No business
Mon.	July 14	In Ljubljana, at Agrostroj
Tues.	July 15	Filed application with personnel services at Hidromontaza
Wed.	July 16	At TAM (Factory for Automobiles and Engines)
Thurs.	July 17	Interview for engineer-manager at IMV (Industry for Motor Vehicles)
Fri.	July 18	Discussed employment with Zrece Forging Industry
Sat.	July 19	Talks with Maribor Foundry regarding bronze castings for automotive applications
Sun.	July 20	No business
Mon.	July 21	Discussed Amway with Josef and Stefka Korosec at their summer home in Sestrze.
Tues.	July 22	Made travel arrangements to return to U.S.

Wed.	July 23	No business
Thurs.	July 24	No business
Fri.	July 25	IMV (Industry for Motor Vehicles)
Sat.	July 26	Went to Agrostroj in response to a cable
Sun.	July 27	No business
Mon.	July 28	Went to Zrece Forging Industry in response to a cable re: employment. Discussions also held regarding import/export of hand tools.
Tues.	July 29	Arranged return trip
Wed.	July 30	Travel to U.S.
Thurs.	July 31	Travel to U.S.

While in Yugoslavia, Ivan received a letter dated July 18, 1980, from Agrostroj, Ljubljana (an "Enterprise for Manufacturing and Repair of Agricultural and Forestry Mechanization"). That letter answered Ivan's inquiry regarding employment in Morocco, and gave details if Ivan wished to further pursue the matter. In the United States, Ivan received another letter from Agrostroj dated August 27, 1980. This second letter contained an offer of employment as a process engineer including 5-year occupany of a three-bedroom condominium, apparently the hallmark of an executive position in Yugoslavia.

By letter of September 30, 1980, the Unior Zrece Forging Industry wrote Ivan at a post office box in Troy, Michigan, also with an offer of employment including a three-bedroom condominium. This offer stated the available job was in the process design department of the machine building division, and explained that division's work in some detail. Ivan would not be working with automobiles at Unior, except that his division would make some forgings for the auto industry.

Finally, by letter of October 6, 1980, IMV Industry for Motor Vehicles Novo Mesto wrote Ivan at his post office box with an offer of employment including a three-bedroom condominium. This offer described Ivan's work as involving introduction of new programs from cooperation with Renault.

Despite testimony that he was job-hunting and open to relocating in Yugoslavia, Ivan rejected all these offers. Ivan discussed importing mopeds and outboard motors with Tomos, Incorporated but because of high interest rates, no deal was struck. Negotiations regarding auto parts, and presumably those regarding irrigation pipes fell through for the same reason.

Petitioners introduced into evidence an Application for Amway Distributor Authorization dated February 18, 1980, which they both signed, and an Amway Distributor Identification Card issued in their names for the year 1980. Also admitted were business cards and an undated Amway order form for an "SDP Kit" which is the $55.75 start-up kit all Amway distributors must buy to familiarize themselves with and demonstrate the Amway household products available for sale. Petitioners' personal use of these products occurred when they were getting acquainted with the products and when they used up bottles too empty to present to customers.

Petitioners, believing their area was saturated with Amway distributors, tried to expand their Amway business when they were in Europe. Amway had established a network in Japan and Germany, and petitioners brought to Europe with them Amway literature specially made for Germany and Austria. Although petitioners could not name the person, they stated they "sponsored"[9] someone as a European Amway distributor. No money was ever received from that party, however. Marija explained this saying "[t]hey did not pursue it any further," and "they would have to go back to the people in Germany that were in charge of that distribution."[10] Ivan explained this saying "[t]hey never made it big enough."

Having made no headway internationally or, apparently, domestically, petitioners got out of the Amway business in the end of 1980. Thus, as was the case with Ivan's interest in returning to work abroad, petitioners' Amway activity waned shortly after they returned from Europe.

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[9] We are not informed as to what "sponsoring" means in the Amway vernacular.

[10] No explanation was offered to show why, if German customers had to purchase from German distributors, petitioners did not learn this information before they left for Europe.

No contracts were signed or products or services sold by petitioners while they were in Europe, with the possible exception relating to Amway noted above. In short, business may have been discussed, but none was consummated.

The Neubauer Property

Ivan owns a residential house situated on tilled field, forest and meadow lands totaling about 10 acres in Sestrze County, Yugoslavia. The property is improved with a barn, stables and a garage, all of solid brick construction. Ivan acquired this property pursuant to a deed of trust contract dated October 25, 1975, for a price of $60,000, divided $50,000 for the buildings and $10,000 for the land.[11] The property is identified by its land parcel numbers in the Register of Land Deeds for Sestrze County;[12] the only address shown there is "Sestrze 3." No deed[13] or contract of sale is in the record,[14] despite the presence of many other less important Yugoslavian documents relating to the property.[15]

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[11] The transaction was handled for Ivan by his brother-in-law, a Yugoslavian attorney who held Ivan's power of attorney.

[12] We note that except for this, the most authoritative evidence of ownership petitioners produced, all other references in the record locate the property in Ptuj County.

[13] Ivan testified that the document signed on a transfer of property in Yugoslavia is physically placed in the official court records, and that he has never seen the document signed on the transfer of his property. This was signed by his Yugoslavian attorney. See n. 11, above.

[14] From whom Ivan acquired title is, therefore, unclear. Ivan testified that he bought the property from his step-sister and two other sisters. However, the Power of Attorney petitioner (footnote continued)

Before Ivan acquired the property, his mother, Alojzija Neubauer, lived there intermittently. At the time of acquisition, she lived across the street from the property, with her sister. After the acquisition, around October 1975, she moved back to the property, but left soon after.[16]

Around October 20, 1975 Ivan's nephew, Vinko Sagadin, moved in. He stayed until the end of 1977. Ivan allegedly charged Sagadin rent of $2,000 a year plus taxes and utilities, but Sagadin actually paid nothing. Instead, Ivan "gave him an interest free loan." Sagadin was a blacksmith who used the property for his trade as well as residence. Some of the amount Ivan "lent" Sagadin was later paid in the form of work Sagadin did on the house.

When Sagadin left the property at the end of 1977, Ivan's mother Alojzija, moved back in. Ivan testified that since that time he tried to rent the property by word of mouth and a posted sign. He testified these were customary methods. He further

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(footnote continued from previous page)
introduced in evidence authorizes Ivan's brother-in-law to buy for Ivan the property from "Neubauer Alojzija, born Frangez." Ivan's mother's name is Alojzija Neubauer.

[15] For example, records of insurance and taxes for the property.

[16] The record is silent regarding what, if any, rent was being paid during these periods of residency by Ivan's mother.

testified that according to local custom and practice, the caretaker of real estate normally does not have to pay anything for rent over and above provided caretaker services.[17] The mere obligation to provide these services, however, proved a sufficient rental disincentive, Ivan stated, to keep the property unrented to anyone other than Alojzija Neubauer.[18]

The only 1980 compensation which appears in the record from Alojzija Neubauer for use of the property is her payment of $166 in taxes and insurance on the property.[19] Petitioners offered no evidence of what comparable properties in the area rent for.

As of June 4, 1981, the Counties of Ptuj and Ormoz officially announced the construction of the "Accumulation Medvedce," apparently a water reservoir. According to the announcement, the reservoir was to straddle two counties, Ptuj and Slovenska Bistrica.[20] Ivan testified that he knew in 1975, at the time of his purchase of the property, that this reservoir was planned. He further testified that the reservoir referred to in the bulletin was to be near his property, that the reservoir would be a "most important development," and that as a result of economic circumstances the reservoir had not yet at the time of trial been constructed. Finally, Ivan testified that the property was bought with the intention of making a profit[21] through either its rental to vacationers and tourists after the reservoir was built or its potential sale for construction of cottages or recreational facilities. No independent evidence is in the record indicating that the reservoir would be available for recreational use, or that the forthcoming development was such that it could be expected to bring increased recreational use to the area.[22]

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[17] Ivan testified as to the existence of a Yugoslavian law requiring the fields to be worked as a condition of ownership. The record does not disclose to what extent Vinko Sagadin complied with this law while paying $2,000 more rent annually than Ivan's mother and conducting his own blacksmithing business. We likewise are uninformed about who tended the fields before Sagadin moved in.

[18] Moreover, Ivan testified that, unlike Americans, Yugoslavians don't move around much.

[19] Ivan testified that this was $166 more than the fair market value, if the tenant cared for the lands. We note that the insurance statement in the record shows coverage only from September 17, 1980. Since the record is silent as to events since 1980, we are uninformed as to whether Ivan's mother paid more than $166 in 1981 or later years because of greater insurance coverage.

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[20] We note that the register of land deeds in which the subject property was scheduled is the Register of Land Deeds for Sestrze County. See n. 12, above.

[21] Ivan anticipated a few loss years until the reservoir was completed.

[22] We note, however, that petitioners' itineraries show that at least two parties, the Korosecs and Sagadin Valentin, were vacationing from Germany in Sestrze prior to the reservoir being built.

Petitioners introduced into evidence copies of three checks, issued approximately quarterly beginning in January, 1980 to Ivan's mother in amounts of $200, $300 and $500. Ivan testified that these were cashed, and the cash used to pay laborers who improved the house in Sestrze County.

Pages of a diary bearing notations of income and expense for the property were also introduced. For example, the annual rental payments Vinko Sagadin owed are shown. Also, notations described the purposes to which the above checks were to be put: the $200 check was an advance for window shutter repair; the $300 check was to cover the balance of the shutter repair and painting and to provide a $50 advance for other repairs; the $500 check was to allow Ivan's mother to begin a major remodeling to include installation of a toilet, bathtub, water heater, space heater, and septic tank and all necessary plumbing.[23] Although Ivan testified to the contrary, each diary entry appears to have been made contemporaneously with the others, although the diary covers transactions purportedly occurring over five years.

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[23] Also noted in the diary was that additional remodeling funds came from those on deposit with Ivan's brother-in-law ($3,500) and those owed by Vinko Sagadin ($450). The diary also states that Vinko Sagadin repaid the balance of his interest-free loan ($2,950) to Ivan, which the latter brought back to America with him after his trip to Yugoslavia, described above. We are uninformed whether Ivan took his cousin's rental payments into income at this, or any other time. They are not reflected on petitioners' 1980 return.

Ivan testified that he and Marija were in Europe to inspect their investment property for the purpose of safeguarding and maintaining it. He testified further that $7,500 in capital improvements and $450 in repairs have been made on the property. He stated $4,500 of the capital improvement was done during the 1980 trip, and all of the $450 in repairs were expenses incurred in 1980. The only independent corroborative evidence supporting Ivan's testimony on these points was the copy of the three checks and the diary. When petitioners were in Sestrze, they spent an unspecified number of evenings working on the improvements or repairs and an unspecified amount of time supervising the laborers.

OPINION

Petitioners justify deductions for the costs of their trip, both those challenged in the petition and those first raised on brief, by stating their trip was business related. They identify four business reasons for the trip: to develop import/export business, to develop Amway business, to seek employment, and to safeguard and maintain their business property. Respondent counters that the primary purpose of the trip was personal, that petitioners had neither any trade or business outside their regular employment during 1980, nor any existing business investments to which the expenses could be related, and that if any business was conducted it was, at best, minor and incidental.

In any event, respondent continues, petitioners have failed to allocate any of their expenditures between business and personal expenses.

Petitioners claim the Sestrze property was acquired and held for the production of income. Respondent argues that because the property was used by Ivan's mother throughout the year for less than a fair rental, any loss deductions which might otherwise be available are denied.

We initially address the items first raised on brief. Under Rule 34(b)(4)[24], "Any issue not raised in the [petition] shall be deemed to be conceded." This Court recently held in a context similar to this that where a party would be prejudiced by an adverse party's first raising a legal theory on brief, the theory is not properly before the Court. Johnsen v. Commissioner, 83 T.C. 103, 119-121 (1984). The rationale for the rule is that the party may have been able to mount sufficient evidence to prevail under the new theory or rebut the new matter, had he been apprised of it in sufficient time. We therefore do not consider the $507 in expenses first claimed by petitioners on brief.[25]

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[24] All Rule references are to the Tax Court Rules of Practice and Procedure. All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue.

[25] See Rabb v. Commissioner, T.C. Memo. 1972-119; Tolins v. Commissioner, T.C. Memo. 1963-34.

We next address the deductions disallowed in the notice of deficiency. Deductions are a matter of legislative grace and petitioners must establish their entitlement thereto. New Colonial Ice v. Helvering, 292 U.S. 435 (1934); Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a).

Ordinary and necessary traveling expenses incurred while away from home in the pursuit of a trade or business are deductible. Sec. 162. Moreover, ordinary and necessary expenses incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income are deductible. Sec. 212.

Expenses, however, which are incurred preparatory to entering a business are not deductible as expenses incurred in pursuit of a trade or business under section 162. Estate of Rockefeller v. Commissioner, 83 T.C. 368 (1984), affd. 762 F.2d 264 (2d Cir. 1985), cert. denied 106 S.Ct. 604 (1985); Frank v. Commissioner, 20 T.C. 511 (1953) (predecessor of section 162). Likewise, no expense in respect of a preliminary search for a potential business opportunity is allowed as a deductible expenditure under section 212. Dean v. Commissioner, 56 T.C. 895 (1971); Frank v. Commissioner, supra (predecessor of section 212).

Petitioners' import-export business activities fall squarely within the above-stated rules. Their travel expenses are not deductible under the theory that they were incurred in connection with that business.

Petitioners present a slightly more appealing case with the Amway argument. Here, they have some evidence to corroborate their testimony. That evidence, however, including an application for an Amway distributorship, business cards and an invoice showing the purchase of a sample kit, falls short of showing that their activities were anything more than in preparation for a business which was ultimately abandoned.[26]

Moreover, we take note of the relationshps between petitioners and their Amway targets.[27] We also note that Amway presentations were made to each potential customer not once, but on two or three separate occasions. We give little weight to the evidence regarding the business purpose of the visits described.

The above result is not changed by virtue of the fact that petitioners may have been holding themselves out as operating under the name of AEI, which may have had income prior to the trip.[28] See Estate of Rockefeller v. Commissioner, supra (being governor different business from being vice-president); O'Donnell v. Commissioner, 62 T.C. 781 (1974), affd. without published opinion 519 F.2d 1406 (7th Cir. 1975) (rejecting integration of related activities).

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[26] See Fryer v. Commissioner, T.C. Memo. 1974-77 (European trip not deductible even where orders placed and agreements reached); Sheban v. Commissioner, T.C. Memo. 1970-163 (no deduction even where option to buy property signed).

[27] The Hlebcars and Sauers were relatives of Marija and the Korosecs long time acquaintances. Although the record does not reveal the relationship of Sagadin Valentin, we note that Vinko Sagadin is a relative of Ivan's, and names appear to have been inverted elsewhere in this record. See n. 14, above.

[28] Since not before us, we express no opinion as to the propriety of scheduling income from Marija's distribution activities on a Schedule C, or as to the potential for the expenses involved here to be capitalized or amortized.

We next turn to petitioners' reliance on Ivan's job-seeking activities. We first note that petitioners have not claimed that this justification supports deductions for Marija's expenses. It could not. Duncan v. Commissioner, 30 T.C. 386 (1958). We therefore confine our examination to whether Ivan's limousine, plane and train fares are deductible under this theory.

Generally, expenses incurred in seeking employment in the same trade or business are deductible under section 162(a). Primuth v. Commissioner, 54 T.C. 374 (1970). However, to obtain a section 162(a) deduction for their expenses in traveling to and from Europe, petitioners must show the expenses were directly attributable to the business of the taxpayer. Section 1.162-1(a), Income Tax Regs. See also Sholund v. Commissioner, 50 T.C. 503 (1968).[29]

We have carefully perused the record and conclude that petitioners' trip was primarily personal. Much of the time spent was with family and friends or acquaintances. Our observations above regarding petitioners' Amway activities are relevant here. Moreover, petitioners offered no specific reasons why Ivan rejected all three of his employment offers. Based on our observations of petitioners at trial, and the entire record, we conclude that Ivan's job-seeking activities were not good faith attempts to find alternative employment, but casual inquiries, made because petitioners thought they would support their tax deduction claims. Ivan's claimed travel expenses are not deductible as related to employment-seeking.[30]

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[29] See also Brotman v. Commissioner, T.C. Memo. 1977-65.

We next turn to petitioners' last justification for their travel expenses, that they were incurred in connection with their Yugoslavian property. Since resolution of this issue involves principles also relevant to the allowability of the loss deduction petitioners claimed on their property, we discuss the two issues together.

In Johnson v. Commissioner, 59 T.C. 791 (1973), affd. without discussion of this point 495 F.2d 1079 (6th Cir. 1974), cert. denied 419 U.S. 1040 (1974), we set out the principles that govern the question of whether expenses incurred in connection with holding property are deductible. We adopt much of the immediately following discussion from that case.

The holding of a single property for rent may constitute a trade or business, LaGreide v. Commissioner, 23 T.C. 508, 512 (1954); Hazard v. Commissioner, 7 T.C. 372 (1946). Moreover, property held for rental purposes may be held for the production of income within the provisions of section 212. Horrmann v. Commissioner, 17 T.C. 903 (1951). In determining whether the holding of property for rental is a trade or business within the meaning of section 162, or is a holding of property for the production of income within the meaning of section 212, the intention of the taxpayers as to the use of the property is of paramount importance.

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[30] Even if the fares were deductible under sec. 162, they would be limited under sec. 274, and the regulations thereunder.

Petitioners' activities must be "sufficiently systematic and continuous to place [them] in the business of real estate rental," before section 162 will apply. Curphey v. Commissioner, 73 T.C. 766, 775 (1980). In this case, petitioners' activities with respect to their real estate were not shown to be any more than isolated. Petitioners were not in the real estate business.[31]

In order then for petitioners to recover they must demonstrate they had a profit-seeking motive in acquiring and holding the property. If the predominant purpose and use of the property was for some nonprofit motive, rather than to derive income, they are not entitled to the deductions claimed. Carkhuff v. Commissioner, 425 F.2d 1400 (6th Cir. 1970), affg. a Memorandum Opinion of this Court; sec. 1.212-1(c), Income Tax Regs. See also Schley v. Commissioner, 375 F.2d 747 (2d Cir. 1967), affg. a Memorandum Opinion of this Court; Rand v. Commissioner, 34 T.C. 1146, 1150 (1960).

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[31] See Wesa v. Commissioner, T.C. Memo. 1982-155 (Despite newspaper advertisements and actual rentals in subsequent years, no trade or business).

Whether petitioners acquired and held the property for rent primarily for the purpose of making a profit is a question of fact to be determined from all the facts and circumstances of the case. No single factor is controlling but greater weight is to be given to objective facts than to the taxpayer's mere expression of intent. Johnson v. Commissioner, supra.

The objective evidence offered to corroborate Ivan's testimony on profit motive was inadequate. Petitioner's strongest evidence, testimony of a $2,000 annual rental payment, was insufficiently corroborated, and in any event conflicted with testimony that mere property maintenance was fair rental.[32] No other evidence of fair market rental was introduced. Testimony was offered that Ivan's mother lived on the property only because no renters could be found, yet only word of mouth advertising and sign posting was used to alert potential lessees. This is patently inadequate in an area which drew vacationers (before any reservoir was built) from across two international borders.[33] Ivan's testimony that he knew of the reservoir in 1975 is not corroborated by a 1980 announcement of its construction. Moreover, no documentary evidence linked the reservoir to increased rental prospects.

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[32] The record does not reveal whether Ivan's cousin provided the required maintenance services while running his blacksmith business. See n. 17, above. Also we note that rental payments were allegedly charged in round numbers of dollars, not Yugoslavian dinars.

[33] See n. 22, above. Austria separates Yugoslavia from West Germany.

We do not think that Ivan had profit on his mind when he bought the property. Ivan may have bailed out poorer relatives to keep the property in the family,[34] or sought to provide a home for his mother. We believe this is a noble gesture. Unfortunately, the reward for it cannot come from the U.S. Treasury. No deduction for travel expenses relative to the property are allowable under section 212.

We now turn to petitioners' claimed losses. Section 262 prevents deductions for family expenses. Again, Ivan's good deed in buying property for his mother to live in is recognized. Expenses incurred in connection therewith, however, are nondeductible under section 262. Respondent is correct that no loss deduction should be allowed.

Decision will be
entered for respondent.

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[34] Ivan testified that "everybody has been paid off" by his purchase of the property.

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UNITED STATES TAX COURT

BOBBY WALRAVEN AND KATHERINE WALRAVEN, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 2402-85. Filed May 21, 1986.

John H. Trader, for the petitioners.

Frank M. Schuler, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GERBER, Judge: Respondent, by statutory notice of deficiency dated October 31, 1984, determined deficiencies in petitioners' Federal income taxes in the amounts of $2,422, $2,231 and $2,493 for the taxable years 1980, 1981 and 1982, respectively. The deficiencies in income taxes are solely attributable to the meals, lodging and car expenses connected with Bobby Walraven's employment at the Callaway Nuclear Power Plant construction site (Callaway). The question for our consideration is whether Bobby Walraven's employment at Callaway was temporary or of indefinite duration. If we find the employment to be temporary, petitioners may deduct the amounts claimed for meals, lodging and transportation for the taxable years 1980, 1981 and 1982.[1] Deductions for the expenditures in question would be pursuant to section 162.[2]

FINDINGS OF FACT

Some of the facts have been stipulated and such facts, together with attached exhibits, are incorporated herein by this reference. Petitioners, at the time of filing of the petition herein, resided at Independence, Missouri. Petitioners filed joint U.S. Individual Income Tax Returns for the taxable years 1980, 1981 and 1982 with the Kansas City Service Center for Internal Revenue Service.

Bobby Walraven (petitioner), through an apprenticeship-type progression beginning in 1948, became a journeyman lineman. From 1948 through 1957 petitioner held various jobs which usually lasted less than one year, the longest of which was 14 months. On occasion, petitioner was unemployed. During 1957, petitioner began work with Evans Electric, which did exclusive contracting for the Independence Power and Light Company, which was owned and operated by the City of Independence, Missouri. During 1967 or

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[1] At the trial, respondent conceded that petitioner had fully substantiated the amounts in question and that, accordingly, the amounts claimed would be fully deductible if we determine that Mr. Walraven's employment at Callaway was temporary.

[2] All statutory references herein are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

1968, the City of Independence "did away with [Evans Electric]" and petitioner began to work directly for Independence Power and Light (City). Petitioner worked a total of 20 years and 11 months in combination for Evans Electric or City (until 1978) as a lineman. During that period, petitioner established his domicile at Independence, Missouri, and has lived in the same dwelling since 1961.

Some of the work performed by journeyman wiremen and linemen are the same, but petitioner did not have specialized training as a wireman and until 1978 worked as a lineman, with the exception of a 3-month period. Petitioner's connection with the local union was as a lineman.

Following a labor dispute, petitioner was terminated by City in August 1978. Shortly thereafter, petitioner, through his union business manager, found work as a wireman at Fort Leonard Wood, where he worked until November 1978. Petitioner believed that the labor dispute with City would abate and that he would eventually be rehired by City but he went to the union business manager who located work at Callaway, a nuclear power plant site near Fulton, Missouri, which was about 150 miles from petitioner's residence in Independence. Petitioner worked continuously at Callaway from November 1978 to May 1979, when he voluntarily quit. Petitioner quit his position at Callaway to take a position with Ford Motor Company nearer his home. During November 1979 (about 6 months later), petitioner was laid off by Ford Motor Company. Petitioner believed he had recall rights at

Ford Motor Company for up to 2 years. In any event, petitioner returned to Callaway during November 1979 and worked without interruption until May 1983.

Callaway was a major project being built by Union Electric Company. Daniel International Corporation (Daniel) was the general contractor for the job and Delcon Corporation, a subsidiary of Daniel, was electrical subcontractor at Callaway. All electrical workers at the Callaway project worked for Daniel through Delcon.

The Callaway project was subject to a project agreement between Daniel, Delcon and Local 257 of the International Brotherhood of Electrical Workers (IBEW). Union Electric Company was not subjected to the contract and it was understood that it could, at its sole option, terminate or suspend at any time any or all portions of the Callaway project. Additionally, the union agreement did not guarantee any employee 8 hours of work per day or 40 hours of work per week. Under the agreement, Daniel or Delcon would prepare a manpower request for a certain number of workers and the union would supply them from its referral list. Once employed, an electrician could be discharged through a reduction in force, for cause, or by voluntarily quitting. In the event of a reduction in force, seniority would not be considered and employees would be laid off based upon their placement in one of four categories, as follows: (A) Book 1 employees (local electricians who belonged to the IBEW Local 257); (B) Book 2 employees (journeyman linemen who came from other IBEW locals elsewhere in the United States); (C) Book 3 employees (union members who were grounds hands, linemen or one of various other classifications); (D) Book 4 employees (nonunion electricians with appropriate experience who would be hired if no union electrician was available). Under the above agreement, Book 4 employees would be laid off first, then Book 3, and so on.

The original plan for Callaway was to build two nuclear power generating units. Work was begun on the first unit late in 1975 and it was scheduled to be completed by October 1981. The second unit was scheduled for completion by April 1983. Due to unforeseen problems, the estimated completion dates were extended several times. As of 1978, the estimated completion dates were October 1982 and April 1986 for the first and second units, respectively. In 1980, the first unit's estimated completion date was extended to April 1983. The revisions and extensions of completion dates were made public by Union Electric Company through various press releases and news conferences. During 1981, plans for construction of the second unit were canceled. Under the terms of the agreement, new workers were required to attend an orientation lecture about Callaway and they were informed of the current estimated time of completion of the project. The Callaway project was approximately 40-percent complete as of November 1979, when petitioner began his second term of employment there.

Prior to 1980 and continuing through the taxable years at issue, petitioner maintained membership in the IBEW Local 53 in Independence, Missouri. Petitioner's classification was that of journeyman lineman in Local 53. The Callaway project was under a union agreement with Local 257 of the IBEW, which was unable to supply the manpower for the Callaway project from its own membership. Throughout the period 1980 through 1983, members of other unions, including petitioner, were employed. Additionally, nonunion electricians were employed through the end of the 1982 year. Petitioner, while employed at Callaway, was a temporary member of Local 257 and during 1980, 1981 and 1982, Local 257 had approximately 150 of its own members working at Callaway. During the period November 1978 through May 1979, petitioner was classified as a Book 4 employee. During the period November 1979 through May 1983, petitioner was classified as a Book 3 employee.

While at Callaway, petitioner was assigned to a crew which consisted of 7 to 10 tradesmen. On occasion, when a crew finished a particular project, that crew would be disbanded and petitioner would be assigned to another crew. On some occasions, petitioner was assigned to jobs or crews which involved trades or skills outside of petitioner's basic discipline, e.g., welding. Petitioner's temporary work card with Local 257 was reissued regularly every 3 or 4 months. During the time petitioner worked at Callaway, he was "traveling out of class" which meant he was working as a wireman at Callaway even though he was a lineman. During the time petitioner worked at Callaway, 4 or 5 of his crew members were laid off. Generally, however, during the 1980 to 1983 period, between 322 and 577 electricians were employed at the Callaway project.

Throughout the time petitioner worked at Callaway he was in contact, usually on a monthly basis, with his union business manager. Inquiries were made about jobs nearer to Independence. During 1981, petitioner made application for a position at Leeds Chevrolet, which was in the Independence area. Sometime during 1980, petitioner filed two different applications with City but he was not hired by City. On one occasion, petitioner's Local 53 business agent offered him a 2 or 3-week job in the Independence area, but petitioner declined the position.

While on the Callaway project, petitioner lived in trailers, motels and, on one occasion, subleased an A-frame. Petitioner generally was transient, remaining in the Callaway project area during the week and going back to Independence on the weekends. Petitioner maintained all of his personal and social ties in Independence and did not permanently establish himself at Jefferson City or at the site of the project. Petitioner did not license vehicles, obtain telephone service, join religious or social organizations near the Callaway project. Petitioner generally would take his clothing and personal belongings back to Independence each weekend but left his tools at the Callaway work site. Following more than 42 months of continuous employment at the Callaway project, petitioner was laid off during May 1983.

OPINION

Our consideration in this case is limited to the question of whether petitioner's employment at Callaway was "temporary" or "indefinite."[3] Section 162(a)(2) would permit a deduction for lodging, meals and travel if incurred in connection with a trade or business while away from home. Generally, a taxpayer's home for purposes of section 162(a) is the area or vicinity of his principal place of employment. Commissioner v. Stidger, 386 U.S. 287 (1967). If a taxpayer leaves his principal place of employment on a temporary basis, his tax home may remain in the vicinity of his prior place of employment and he may be entitled to deductions for expenses while away from home under section 162(a). Temporary employment for purposes of applying this exception has been defined as that which can be expected to last for only a short period of time. Norwood v. Commissioner, 66 T.C. 467, 469 (1976). If, however, employment is not expected to terminate within a "fixed or reasonably short period of time" it will be considered indefinite. Stricker v. Commissioner, 54 T.C. 355, 361 (1970), affd. 438 F.2d 1216 (6th Cir. 1971).

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[3] Respondent has not raised and, accordingly, we do not consider any question of commuting between the taxpayer's residence and his job site. See Turner v. Commissioner, 56 T.C. 27 (1971), vacated and remanded on respondent's motion by unpublished order (2d Cir., Mar. 21, 1972); McCallister v. Commissioner, 70 T.C. 505 (1978).

The temporary-versus-indefinite question is one of mixed fact and law to be resolved by applying the correct legal standard to the facts of the individual case. In Cockrell v. Commissioner, 321 F.2d 504 (8th Cir. 1963), affg. 38 T.C. 470 (1962), the standard was described as follows:

> "Where it appears probable that a taxpayer's employment outside the area of his regular abode will be for a 'temporary' or 'short' period of time, then his travel expenses are held to be deductible; conversely, if the prospects are that his work will continue for an 'indefinite' or 'intermediate' or 'substantially long' period, then the deduction is disallowed." * * * [321 F.2d at 507, quoting Wright v. Hartsell, 305 F.2d 221, 224 (9th Cir. 1962).]

In Frederick v. United States, 603 F.2d 1292, 1296 (8th Cir. 1979), the standard in Cockrell was further refined as follows:

> Cockrell demands that a court investigate the taxpayer's prospects of continued employment. In other words, a court must evaluate those facts available to a taxpayer at a point in time and determine, in light of those facts, whether future employment was for a temporary or indefinite period. * * *

Applying these tests, we conclude that respondent's determination must be sustained, and that petitioner's employment at Callaway during the taxable years 1980, 1981 and 1982 was indefinite rather than temporary in nature. In arriving at this conclusion, we take into account the following factors which are supported by the record: (1) The Callaway project was a major one and petitioner was made aware of its proposed completion date upon his orientation and entry into the project on two different occasions. Additionally, announcements of extensions of time within which the first nuclear unit was to be completed were made public by Union Electric Company. (2) During the period of time that petitioner was employed at Callaway, the number of electricians on the project varied at approximately 300 to 500 and Local 257, of which petitioner was a temporary member, only had 150 electricians within its regular membership. There was, accordingly, a regular and continuing need for electricians at the project during the entire time under consideration. (3) During the period in question, petitioner was a Book 3 employee which entitled him to some priority over Book 4 employees in the event of a reduction in force. And, even a nonunion electrician could only be fired for cause, by reduction in force or by voluntarily quitting. The work at the Callaway project was not seasonal in nature and, but for petitioner's decision to quit in May 1979 to work for Ford Motor Company, he may have continually been employed at Callaway from November 1978 through May 1983. (4) Petitioner was not interested in short-term jobs in the Independence area (2 or 3-week positions) because he wished longer-term employment. It appears that petitioner was not willing to accept anything other than permanent-type employment in the Independence area and from this we can reasonably assume that he expected his position at Callaway to be something other than short-term.

Respondent's position is that this case does not differ significantly from six prior "Callaway cases" heard by this Court. Van Horn v. Commissioner, T.C. Memo. 1983-693; Myers v. Commissioner, T.C. Memo. 1983-696; Rutherford v. Commissioner, T.C. Memo. 1983-697; Kostos v. Commissioner, T.C. Memo. 1983-698; Schurwan v. Commissioner, T.C. Memo. 1983-699; Nulsen v. Commissioner, T.C. Memo. 1984-307. Respondent relies most heavily upon Nulsen v. Commissioner, supra, since Mr. Nulsen was a nonunion electrician and worked at Callaway as a Book 4 employee for a period of time similar to petitioner (Mr. Nulsen worked from November 26, 1979, until April 9, 1982). Respondent points out that under the terms of the project agreement, Mr. Nulsen would have been laid off before petitioner since Mr. Nulsen was a Book 4 employee and petitioner was listed under Book 3.

Petitioner cites a number of cases, attempting to distinguish himself from the six prior employees of Callaway who were unsuccessful in their cases before this Court. Petitioner argues that Union Electric Company could have terminated the project at any time at its sole option and that, further, the project agreement did not guarantee any employee 8 hours of work per day or 40 hours of work per week. Additionally, petitioner, in his testimony, emphasized that his living conditions in the Callaway project area were always transient and temporary and that he never acquired any permanent residence or domiciliary in the project area. Petitioner's emphasis of this point misses the mark because the test is not whether it was reasonable for the taxpayer to move his home closer to the job site. It is the job itself and its expected duration that is crucial. Frederick v. United States, supra at 1295.

Petitioner cites four Memorandum Opinions of this Court and a District Court case that he advances in support of a holding that his employment was temporary. In *Williams v. United States*, 573 F. Supp. 14 (E.D. Ark. 1983), it was held that the employment of an electrician working at a nuclear power plant was temporary. The facts of *Williams v. United States*, *supra*, are distinguishable because in *Williams* the first of two nuclear reactors had been completed and the second one was under construction. Additionally, there was some question when the taxpayer was on the job as to whether the second nuclear power plant would ever be completed and placed in operation. Even more directly, in *Williams*, 6 months after the taxpayer began work, a very large layoff of electricians occurred; at one point, work on the second nuclear reactor was stopped for cash-flow problems and there was a gradual and continual decline in the number of electricians being maintained on the project. Unlike *Williams*, petitioner's actual experience with layoffs of electricians was limited and the number of electricians employed showed no signs of decreasing.

The remaining cases cited by petitioner are inapposite and involve circumstances substantially dissimilar to the facts of this case.

Based upon the facts of this case, petitioner's prospects for continued employment at Callaway for an indefinite period were excellent. Considering the size of the project and the demand for workers (which was far beyond the local union's ability to supply) it would have been unreasonable for petitioner to have concluded otherwise. We find this case materially indistinguishable from prior precedents involving Callaway employees and, accordingly, respondent's determination is sustained.

Decision will be entered for

the respondent.

JU11.7/2: 1986-206

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COMPLETED

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ORIGINAL

T. C. Memo. 1986-206

UNITED STATES TAX COURT

E. G. SORIA, Petitioner v. COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 23579-85. Filed May 21, 1986.

Darryl V. Rippy, for the petitioner.

George Nassif, for the respondent.

MEMORANDUM OPINION

BUCKLEY, Special Trial Judge: This matter was assigned to the undersigned pursuant to Rules 180, 181 and 183, Tax Court Rules of Practice and Procedure. It is before us on respondent's motion to dismiss for lack of jurisdiction.

G.M.

Petitioner on July 5, 1985, filed a petition to this Court in regard to his 1982 taxable year. He alleged therein that he had not received a notice of deficiency from respondent for that year and stated that he believed the records of the Internal Revenue Service indicated that such a notice was mailed. He also alleged that if such notice was mailed, it was not sent to petitioner's last known address in accordance with section 6212.[1] Petitioner resided at Fountain Valley, California, at the time of filing his petition herein.

A statutory notice of deficiency was mailed by certified mail to petitioner on July 19, 1984, regarding his 1982 taxable year. The notice was mailed to him at 18642 Libra Circle #1, Huntington Beach, California. That address was the one shown on petitioner's 1982 tax return.

If respondent's notice was sent to petitioner's last known address, the petition to this Court must have been filed on or before October 17, 1984, in order for it to be timely and for this Court to have jurisdiction over this matter. Sec. 6213. As noted, the petition in fact was filed July 5, 1985.

Petitioner's 1983 Federal income tax return was filed on or before April 16, 1984. The address shown on that return was 17320 Euclid, Fountain Valley, California. Petitioner contends that respondent at the time of mailing the notice of deficiency to petitioner on July 19, 1984, had notice of petitioner's new address at Fountain Valley as a result of the new address shown on petitioner's 1983 return. Thus, petitioner contends that the notice of deficiency was not sent to petitioner's last known address and hence is invalid.

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[1] Section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

Our question is therefore whether respondent had reasonable knowledge of the fact that petitioner's address had changed from Huntington Beach to Fountain Valley when respondent mailed the deficiency notice. This is, of course, a question of fact. Maxfield v. Commissioner, 153 F.2d 325, 327 (9th Cir. 1946). The Internal Revenue Service, as a general rule, is entitled to treat the address appearing on the return for the year in question as the last known address, absent "clear and concise notification" of a new address. Alta Sierra Vista, Inc. v. Commissioner, 62 T.C. 367, 374 (1974), affd. without published opinion 538 F.2d 334 (9th Cir. 1976). We recognize that the "last known address" to which the notice of deficiency is mailed assumes great importance in the taxpayer's ability to obtain a prepayment judicial redetermination of his tax liabilities. Unfortunately, the phrase "last known address" is not defined in the applicable Code section or attendant regulations. We held in Brown v. Commissioner, 78 T.C. 215, 218-219 (1982), that this phrase means:

> the taxpayer's last permanent address or legal residence known by the Commissioner, or the last known temporary address of a definite duration to which the taxpayer has directed the Commissioner to send all communications during such period.

> Weinroth v. Commissioner, 74 T.C. 430, 435 (1980); Alta Sierra Vista, Inc. v. Commissioner, 62 T.C. 367, 374 (1974), affd. without published opinion 538 F.2d 334 (9th Cir. 1976). Stated otherwise, it is the address to which, in light of all the surrounding facts and circumstances the respondent reasonably believed the taxpayer wished the notice to be sent. Weinroth v. Commissioner, supra; Looper v. Commissioner, 73 T.C. 690, 696 (1980). The relevant focus is thus on the Commissioner's knowledge rather than on what in fact may have been the taxpayer's actual address in use. Alta Sierra Vista, Inc. v. Commissioner, supra.

We have held, generally, that the filing of a subsequent return with a change of address does not constitute such clear and convincing evidence. Weinroth v. Commissioner, 74 T.C. 430, 436-437 (1980); Budlong v. Commissioner, 58 T.C. 850, 852-853 (1972). However, we follow, for purposes of this matter,[2] the holdings of the Ninth Circuit to the effect that a subsequently filed tax return with a new address does give the Internal Revenue Service notice of the new address. See, e.g., United States v. Zolla, 724 F.2d 808, 810 (9th Cir. 1984). We must face the question here, however, as to just when the Internal Revenue Service had such notice, whether on the filing date of the 1983 return or at some other time subsequent thereto. If the Internal Revenue Service did not have effective notice until after

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[2] Golsen v. Commissioner, 54 T.C. 742 (1970), affd. 445 F.2d 985 (10th Cir. 1971), cert. denied 404 U.S. 940 (1971). Since any appeal herein lies to the Ninth Circuit, we follow that Court for purposes of our determination of jurisdiction herein.

July 19, 1984, of a change of address, our jurisdiction over this matter must fail. Petitioner's 1983 return was timely filed on or prior to April 16, 1984, with the Fresno Service Center of the Internal Revenue Service. The transcript of the Internal Revenue Service's National Computer Center indicates that petitioner's new address as indicated on his 1983 tax return was not posted until August 27, 1984, some 39 days after the issuance of the notice of deficiency. The delay between the return's timely filing date of April 16, 1984, and the computer posting of petitioner's 1983 return was, therefore, at least 19 weeks, or approximately four and one-half months. Respondent's procedure for the posting of return information, during the peak processing period, is to set aside returns that come in fully paid in order to process first returns upon which refunds are claimed. After the refund returns are posted, the Service Center then turns to the handling of non-refund returns. Petitioner's 1983 return was such a return.

Not until August 27, 1984, did the information contained on the return about petitioner's new address become available to respondent for discovery. Respondent's transcript indicates that petitioner's 1983 return was handled by the Service Center in the normal course of its business.

The mere fact that the 1983 return was filed on or before April 16, 1984, does not serve to provide respondent with actual notice of petitioner's change of address. It would be unreasonable to ascribe respondent with notice solely because of physical control of the return at the Fresno Service Center. We take notice of the fact that the Fresno Service Center handled great numbers of returns during this period.

Petitioner does not allege that he notified the Internal Revenue Service of an address change nor that the notice of deficiency was returned to the Internal Revenue Service from his Huntington Beach address so as to give them notice of an address change. We note that even had it been returned to the Internal Revenue Service after its issuance, petitioner's new address would not have been available to them until August. See Singer v. Commissioner, T.C. Memo. 1986-193. Nothing occurred in this matter to alert the Internal Revenue Service that the notice had not in fact been received by petitioner. Compare Wallin v. Commissioner, 744 F.2d 674 (9th Cir. 1984).

Under the circumstances herein, we find that the Internal Revenue Service acted reasonably in mailing the notice of deficiency to Huntington Beach. Petitioner had not, as a practical matter, advised the Internal Revenue Service of his change of address as of the date of mailing of the notice. See Bagwell v. Commissioner, T.C. Memo. 1984-93. There is nothing in the record to indicate that prior to the issuance of the statutory notice, respondent had any communication with petitioner at his new address. Cf. Pyo v. Commissioner, 83 T.C. 626 (1984). Further, no information whatsoever has been presented to indicate that the Internal Revenue Service knew that petitioner did not receive the notice.

Since our jurisdiction is predicated upon the timely filing of a petition to this Court within 90 days of the issuance of the deficiency notice (sec. 6213) and since petitioner failed to so file, we must grant respondent's motion to dismiss for lack of jurisdiction.

An appropriate order will be issued.

JU11.7/2:1986-207

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ORIGINAL

T. C. Memo. 1986-207

UNITED STATES TAX COURT

WAYNE E. STEVENSON AND MARILYN J. STEVENSON, ET AL.,[1]
Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 15671-81,
10897-82,
10898-82.

Filed May 21, 1986.

Robert A. Hutchison and John V. Donnelly, for the petitioners in docket No. 15671-81.

Robert J. Murray, for the petitioners in docket Nos. 10897-82 and 10898-82.

J. Anthony Hoefer, for the respondent.

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[1] Cases of the following petitioners are consolidated herewith: J. L. Griffith and Connie Griffith, docket No. 10897-82; Ronald E. Nielsen and Carolyn M. Nielsen, docket No. 10898-82.

Cl.M

MEMORANDUM FINDINGS OF FACT AND OPINION

PARKER, Judge: In these consolidated cases, respondent determined deficiencies in petitioners' Federal income taxes as follows:

Docket No.	Petitioners	Year	Deficiency
15671-81	Wayne E. Stevenson and Marilyn J. Stevenson	1974	$ 5,259
		1977	104,214
10897-82	J. L. Griffith and Connie Griffith	1977	27,438
10898-82	Ronald E. Nielsen and Carolyn M. Nielsen	1977	29,672

After concessions,[2] the sole issue for decision is whether petitioner Wayne E. Stevenson received a guaranteed payment taxable pursuant to sections 707(c)[3] and 736(a)(2) upon his departure from an accounting partnership in which petitioners J. L. Griffith and Ronald E. Nielsen were also partners. Respondent is essentially a disinterested stakeholder in this case, concerned only that the Court treat all of the partners consistently. To protect the revenue, respondent has taken inconsistent positions, treating the entire guaranteed payment of $234,401 as ordinary income to petitioner Stevenson, on the one hand, and denying the deduction to the partnership and hence denying deduction for their allocable portion of the expense to petitioners Griffith and Nielsen, on the other hand.

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[2] The Griffiths and the Nielsens concede respondent's denial of claimed section 1244 losses and bad debt deductions.

[3] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the taxable years in question, and all "Rule" references are to the Tax Court Rules of Practice and Procedure.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and the exhibits attached thereto are incorporated herein by this reference.

Petitioners Wayne E. Stevenson (Stevenson) and Marilyn J. Stevenson, husband and wife, resided in Urbandale, Iowa, at the time they filed their petition in this case. Petitioners J. L. Griffith (Griffith) and Connie Griffith, husband and wife, and petitioners Ronald E. Nielsen (Nielsen) and Carolyn M. Nielsen, husband and wife, resided in West Des Moines, Iowa, at the time they filed their petitions in this case. The couples filed their joint Federal income tax returns (Forms 1040) for the years in issue with the Internal Revenue Service Center in Kansas City, Missouri. Petitioners Marilyn J. Stevenson, Connie Griffith, and Carolyn M. Nielsen are parties to this case solely because they filed joint Federal income tax returns for the years in issue with their respective husbands.

Stevenson, Griffith, and Nielsen are collectively referred to as petitioners. At all times pertinent hereto, petitioners were certified public accountants engaged in the practice of their profession in the State of Iowa.

Before July 1, 1973, Stevenson practiced certified public accounting in partnership with Wayne L. Simmer (Simmer) in Des Moines, Iowa. On July 1, 1973, Stevenson and Simmer merged their firm into another accounting partnership that became known as Mosebach, Griffith, Simmer & Company (the partnership). The partnership engaged in the profession of certified public accountancy, offering general accounting services, tax advice, and management services to the general public. The partnership had offices in several Iowa cities and towns, including Des Moines, Cedar Rapids, Tama, Muscatine, and Grundy Center.

Pursuant to the merger, Stevenson and Simmer became general partners in the partnership and executed the partnership's agreement of general partnership. Stevenson and Simmer each contributed $50,000 cash to the partnership's capital. To reflect the clients Stevenson and Simmer brought to the partnership, the partnership gave them vested interests in guaranteed payments in the amount of $91,142 each, to be paid upon their departure from the partnership. These guaranteed payments were unfunded. Griffith and Nielsen, along with several other individuals, were also partners in the partnership. Larry F. Mosebach (Mosebach) was, and up to the time of trial continued to be, the partnership's managing partner.

Effective December 31, 1975, the partners, including Stevenson, Griffith, and Nielsen, executed a revised agreement of general partnership (the partnership agreement). The partnership agreement was quite extensive, particularly on matters regarding partners withdrawing from the partnership. The agreement provided that the partnership would repay a departing partner his capital account in 60 equal, monthly installments with interest at the annual rate of 10 percent on the unpaid balance.

The partnership agreement also required the partnership to make guaranteed payments to departing partners and provided that such payments be treated under sections 707(c) and 736(a)(2) as deductible by the partnership and as ordinary income to the departing partner. The partnership agreement contained a lengthy formula for determining the guaranteed payments due each partner and the vesting dates thereof. However, these "vested" guaranteed payments were unfunded and were not reflected as liabilities on the partnership's balance sheet. They were to be paid without interest to a departing partner in equal, monthly installments over a 10-year period beginning after the partner's departure. However, if a partner left before reaching age 55, the 10-year payment period was increased one year for every year between his age at the departure date and age 55.

The partnership agreement prohibited a former partner from providing accounting services to or soliciting business from any partnership client. It obligated a former partner to pay the partnership liquidated damages equal to 200 percent of the greater of the partnership's previous or current year's business volume for any partnership client lost due to a breach of the noncompetition provision.

The partnership agreement permitted a partner to voluntarily withdraw from the partnership on 60 days' notice. It also allowed the partnership to expel a partner "for cause." The agreement listed causes for expulsion, including "[s]ignificant breaches of the Agreement and established Partnership policies and regulations." A partner expelled for cause forfeited his guaranteed payments, which served to satisfy his obligation to pay liquidated damages incurred by the partnership due to the cause for which the partner was expelled.

The partnership agreement made no provision for the sale of partnership clients to departing partners. Amendments to the agreement were not effective until "executed and attached to [the agreement] as a part of the same." The partnership modified the agreement from time to time by attaching to it various exhibits dealing with the amounts of the partners' capital accounts, annual basic compensation, monthly draws, and guaranteed payments.

Over a period of two or three years, some of the partners expressed concern about Stevenson's manner and method of practicing accounting. They thought that Stevenson was not complying with established partnership policies such as timely turning in time records and recording phone calls. They also thought that he sometimes promised work within an unreasonable time frame, maintained sloppy workpapers, failed to follow the partnership's procedures, and inadequately supervised employees. A number of times Mosebach, as managing partner, discussed these shortcomings with Stevenson, who assured Mosebach that he would comply with partnership policies and procedures.

However, the situation came to a head on July 25, 1977. Stevenson prepared a set of financial projections for a group of investors interested in acquiring a Coor's beer distributorship. The investors needed the projections to obtain financing. Partnership policy and procedures required all projections to be reviewed internally before release. Stevenson's projections were not reviewed by the partnership before Stevenson presented them to the investors and the bank officers. The partnership's management committee, consisting of Mosebach, Griffith, and Simmer, was meeting that day and learned that the projections had gone out without being reviewed. The management committee members telephoned the other partners and called a partnership meeting for that evening. After Stevenson returned from his meeting with the investors and the bank officers, Mosebach confronted Stevenson about the infraction and told him that the partners were meeting to vote on his expulsion from the firm. Stevenson was excluded from the meeting.

At the meeting, the management committee explained to the other partners what had transpired that day. After the partners discussed the matter, they voted to expel Stevenson for cause. Mosebach called Stevenson into the meeting and told him that the partners had voted to expel him for cause. Stevenson then left the meeting and went back to his office.

Mosebach later went to Stevenson's office and told Stevenson that he had been expelled for cause but if he would agree to turn over to the partnership the clients that he had brought to the partnership and was personally responsible for, then the partners would change the expulsion to one without cause and pay him the guaranteed payments he would be entitled to under the partnership agreement. Stevenson was then 45 years old, and the guaranteed payments would be made without interest over a 20-year period. If he agreed, Stevenson would get guaranteed payments in the amount of $234,401, payable in equal, monthly installments in the amount of about $975 per month over 20 years. The payments would not bear interest and were unfunded. Stevenson rejected Mosebach's proposal. He told Mosebach that he had been in the accounting profession all his life, that he was going to stay in the accounting profession, and "in so many words told him [Mosebach] what he could do with his guaranteed payments."[4]

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[4] Stevenson's testimony on this point, as on virtually every major point in this case, is in direct conflict with the testimony of Mosebach and Griffith. Mosebach and Griffith testified that although the partners believed they could expel Stevenson for cause they gave him the opportunity to withdraw
(footnote continued)

After this discussion with Mosebach, Stevenson turned the matter over to his attorney, Marvin Winick (Winick). For the next four to six weeks, Stevenson set up offices for his own practice and continued servicing the clients he worked for while he was with the partnership. During that time, Winick negotiated the terms of Stevenson's departure from the firm with Mosebach and Griffith. At Mosebach's request, Stevenson prepared two lists of clients. The first list was of clients whose accounts receivable and work-in-process Stevenson eventually purchased from the partnership. In addition to their names, the list states the dollar volume of work the partnership performed for each client during 1976, and the total thereof, amounting to $109,919. The second list was of clients whose files Stevenson wanted to take with him.[5] Stevenson knew that he would not be working for some of the listed clients because they had already told him they were making other plans to obtain accounting services. Nevertheless, Stevenson wanted the files of those clients because he had been responsible for them and might need

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(footnote continued from previous page)
from the partnership voluntarily, "but one way or another he [Stevenson] was leaving." Griffith further testified that shortly after the partnership meeting, Stevenson told Griffith that he wanted to set up his own practice, which Griffith took as Stevenson's decision to voluntarily withdraw from the partnership. As discussed more fully in our opinion, we generally found Stevenson to be a more credible witness than Mosebach or Griffith.

[5] Mosebach testified that this was a list of clients the partnership sold to Stevenson for $234,401, the amount of the purported guaranteed payment. The Court did not believe his testimony, and the record as a whole shows the facts to be otherwise.

the files to answer any questions they might have in the future. For those clients Stevenson expected to continue servicing, the partnership's 1976 dollar volume of work was between $75,000 and $80,000. The partnership would not have retained most of the listed clients whether or not Stevenson took them with him. No one in the partnership (other than Stevenson) knew anything about those clients. Also, the partnership was not interested in continuing to service several of the listed clients.

On August 23, 1977, Stevenson and his attorney, Winick, met with Mosebach, Griffith, and the partnership's attorney, George Sullivan (Sullivan), to try to resolve the terms of Stevenson's departure. At the meeting, Stevenson presented to Mosebach and Griffith the two client lists he had prepared at Mosebach's request. He also submitted at that time release forms from many of these clients requesting that the partnership turn its files for the clients over to Stevenson. The release forms were not acceptable to Mosebach, so Stevenson had to get the clients to sign additional forms satisfactory to the partnership. He eventually gave the partnership release forms for almost all, if not all, of the listed clients. At the meeting, the parties also discussed the repayment of Stevenson's capital account in the partnership.

On September 6, 1977, Stevenson and the partnership entered into a written agreement (the separation agreement) setting forth the terms and conditions of Stevenson's termination from the partnership. In pertinent part, the separation agreement provided as follows:

> 1. The parties agree that Stevenson will cease to be a partner of the Partnership effective as of the close of business of the Partnership on August 31, 1977, hereinafter referred to as "termination date". The parties further agree that except as provided for in this Agreement, neither party shall have any further liability or obligation whatsoever to the other party and all rights and obligations of Stevenson under the Partnership's partnership agreement including, but not limited to, Stevenson's right to receive any further remuneration or guaranteed payments from the Partnership are terminated as of the "termination date".
>
> 2. It is understood and agreed that Stevenson will continue in the practice of accountancy apart from the Partnership and that he will be rendering professional services to certain present clients of the Partnership listed on Schedule A attached hereto. It is further agreed that contemporaneously with the execution of this Agreement, Stevenson will purchase for cash the work-in-process and billed accounts receivable relating to such clients at the amounts set forth in such Schedule A, and the Partnership will assign, transfer and convey all of their interest in such work-in-process and billed accounts receivable to Stevenson.
>
> 3. Contemporaneously with the execution of this Agreement, Stevenson will purchase the accounts receivable listed on Schedule B attached hereto for the sum of $5,000.00 and the Partnership will assign and convey all of their interest in such accounts receivable to Stevenson.

* * *

5. Contemporaneously with the execution of this Agreement, the Partnership will pay Stevenson the sum of $60,000.00 in full settlement of his capital account in the Partnership.

6. The Partnership shall release to Stevenson from time to time any and all files pertaining to the clients listed on Schedule A attached hereto upon delivery to the Partnership of a release executed by the client and in the form previously furnished by the Partnership to Stevenson. If the release is not in the same form as that furnished by the Partnership, the Partnership will nevertheless release files to Stevenson pursuant to other written forms of release (including telegrams). In such event, Stevenson shall deliver executed releases from such clients on the form furnished by the Partnership within 60 days of the date of this Agreement.

7. The parties agree to cooperate with each other in the connection with the transition of Partnership clients to Stevenson as contemplated hereunder and in matters relating to clients retained by the Partnership. The parties further agree to execute such additional documents as may be necessary to effect the termination of Stevenson's status as a partner in the Partnership and to put into effect the terms and conditions of this Agreement.

There were two Schedule A's attached to the separation agreement, corresponding, with a few changes, to the two client lists Stevenson had prepared and presented to Mosebach at the August 23rd meeting. The first Schedule A (and Schedule B) listed clients whose accounts receivable and work-in-process Stevenson was purchasing from the partnership for $61,146.10. In accordance with the separation agreement, the partnership formally assigned, by a written assignment agreement also executed on September 6, 1977, all of its right, title, and interest to the listed accounts receivable and work-in-process to Stevenson.

As of the close of partnership business on August 31, 1977, Stevenson had contributed $60,000 in cash or other property to the partnership's capital, and as of such date, his paid-in capital account in the partnership had a credit balance of $60,000.[6] Stevenson's $60,000 capital account and expense reimbursements due him in the amount of $212.55 were offset against his obligation to the partnership for the accounts receivable and work-in-process the partnership assigned to him. This left a net amount of $933.55 Stevenson owed the partnership, which he paid by check.

Winick, Stevenson's attorney, drafted the separation agreement. However, both Mosebach and Sullivan, the partnership's attorney, reviewed the agreement before Mosebach signed it. Other than the written assignment agreement executed along with the written separation agreement, there were no other agreements, written or oral, between Stevenson and the partnership regarding his departure from or any interest in the partnership. Stevenson received nothing else from the partnership other than his draw through August 31, 1977, in the amount of $33,028. He did not receive any portion of the partnership's profits for 1977. He did not receive any guaranteed payment.

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[6] The parties have stipulated to this figure of $60,000, and we have accepted their stipulation. We note that Stevenson's schedule K-1 attached to the partnership information return (Form 1065) for the year 1977 shows a capital account at the beginning of the year of $101,139. The record does not show whether, when, or how the other $41,139 of Stevenson's purported capital account was distributed to him; however, in view of other purported errors that Mosebach testified were intentionally made on Stevenson's K-1, the Court accords little or no weight to any representations on the partnership's Form 1065 and attachments thereto.

After departing from the partnership, Stevenson began practicing accounting under the name of Stevenson & Company. He hired two former partnership employees, Michael Beaderstadt and Daniel J. Sigler (Sigler). Shortly thereafter, Stevenson received a letter from Mosebach dated September 15, 1977, which stated as follows:

> We have now learned, two days after the final settlement, of your unethical solicitation of two of our employees.
>
> Our firm negotiated, in good faith with you, a settlement allowing you to withdraw a substantial number of clients, obtain complete files, etc., all completely outside the provisions of our Partnership Agreement.
>
> We certainly do not condone your actions and are sorry to find out that you chose methods other than those recognized as ethical by our profession.

On January 3, 1978, the partnership filed a petition in the District Court of the State of Iowa in and for Polk County, seeking (1) injunctive relief and damages for Sigler's breach of the noncompetition clause of his employment agreement with the partnership, (2) injunctive relief and damages for Stevenson's breach of the partnership agreement's noncompetition clause, and (3) specific performance of the separation agreement's requirement that Stevenson provide the partnership with release forms for all of the client files he took with him. The partnership brought this suit to keep Sigler from performing services for former partnership clients that Stevenson took and to keep Stevenson and his firm from soliciting other partnership clients. The district court granted damages and injunctive relief against Sigler and dismissed the partnership's claims against Stevenson for breach of the partnership agreement, concluding that the separation agreement was a novation of the partnership agreement.[7] Sigler appealed and the partnership cross appealed, but both appeals were dismissed before any additional formal action was taken by the appellate court.

The partnership also sued Stevenson in small claims court for about $110 it claimed Stevenson owed for telephone calls. The court dismissed the case. In addition, the partnership filed a complaint against Stevenson with the ethics committee of the Iowa Society of Certified Public Accountants. That complaint was also dismissed.

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[7] We reiterate our statement at trial that although the Iowa district court's decision may be helpful in considering issues of law, the Court is not bound by any of the district court's factual determinations. See Commissioner v. Estate of Bosch, 387 U.S. 456 (1967) Counsel for Stevenson as well as counsel for the other partners used bits and pieces of the district court record to try to impeach the testimony of Mosebach or Stevenson, respectively, but these efforts contributed more confusion than enlightenment. We place primary reliance upon the sworn testimony given in this proceeding, testimony that was clear, addressed to the issues of the case but in sharp conflict. However, resolving such conflicts in testimony is the ultimate task of the fact finder — "the distillation of truth from falsehood which is the daily grist of judicial life." Diaz v. Commissioner, 58 T.C. 560, 564 (1972).

For Federal income tax purposes, the partnership reported its 1977 income on the accrual method of accounting on a calendar taxable year. Each petitioner reported his income on the cash method of accounting.

Nielsen prepared the partnership's 1977 Federal partnership return of income (Form 1065) including the schedule K-1's (partner's share of income, credits, deductions, etc.) thereto under Mosebach's supervision. Mosebach and Nielsen intentionally made no entry on line 14 of the partnership's return, labeled "Guaranteed payments to partners." On line 24 of the return, labeled "Other deductions," they entered the amount of $613,688. On a supporting statement attached to the return, Mosebach and Nielsen itemized the other deductions, including "Guaranteed Payments--Retired Partners" in the amount of $244,901. They viewed $234,401 of that amount as deductible by the partnership and includable in Stevenson's income. On the supplemental schedule of gains and losses (Form 4797) attached to its 1977 return, the partnership reported section 1231 gain in the amount of $234,401 from "sale of practice." Mosebach signed the partnership's 1977 return under penalties of perjury. On their respective 1977 Federal income tax returns (Forms 1040), Griffith and Nielsen each reported his allocable share of the partnership's items of ordinary income (including deductions) and section 1231 gain, including the items described above.

The partnership provided Stevenson with a schedule K-1 showing that Stevenson had ordinary income from the partnership during 1977 in the amount of $33,028. Mosebach and Nielsen intentionally did not show any other income, including guaranteed payments, from the partnership on the schedule. The schedule K-1 comported with Stevenson's knowledge of the facts and understanding of the transaction. On his 1977 Federal income tax return, Stevenson reported ordinary income from the partnership in the amount of $33,028, the amount indicated on his schedule K-1. Stevenson also claimed a tentative refund for 1974 from unused investment credit in the amount of $5,259. Stevenson did not see a copy of the partnership's return until 1979 when he received a copy of it from the Internal Revenue Service during the audit of his 1977 tax return.

In a statutory notice of deficiency to Stevenson dated April 13, 1981, respondent determined that Stevenson received additional income in the amount of $234,401 in conjunction with his withdrawal from the partnership. Respondent also determined that Stevenson's investment tax credit in the amount of $5,259 reduced his increased 1977 tax liability and consequently was not available as an unused investment credit carryback to 1974. Respondent therefore increased Stevenson's 1974 tax liability by that amount. In statutory notices of deficiency to Griffith and Nielsen dated April 5, 1982, respondent determined that they each had additional income resulting from a disallowance of the guaranteed payments deduction claimed by the partnership in the amount of $234,401.

ULTIMATE FINDINGS OF FACT

1. Stevenson was removed from the partnership for cause.

2. Stevenson did not receive any guaranteed payment upon his departure from the partnership.

OPINION

This case involves a rather bitter dispute among partners of an accounting firm, and respondent is simply a stakeholder in the matter. The issue for decision is whether petitioner Stevenson received a guaranteed payment taxable pursuant to sections 707(c) and 736(a)(2) upon his departure from the partnership. If so, the guaranteed payment is taxable to Stevenson as ordinary income and deductible by the partnership as a business expense. Petitioners Griffith and Nielsen, two of the several other partners, argue that the partnership paid Stevenson a guaranteed payment pursuant to an oral agreement whereby Stevenson and the partnership allegedly agreed to offset the guaranteed payment against the purchase price Stevenson purportedly paid for the right to provide accounting services to certain partnership clients after he left the partnership. The issue is purely a factual one.

At the trial Stevenson objected to the admissibility of evidence in regard to the purported oral agreement, relying on the parol evidence rule. We reserved ruling on Stevenson's standing objection and heard the evidence. For the reasons set forth below, we agree with Stevenson that the evidence is not properly admissible. However, even considering that evidence, the Court cannot find that there was such an oral agreement. We conclude and have found as a fact that the only agreement between petitioner Stevenson and the partnership was the written separation agreement and written assignment agreement, both dated September 6, 1977.

Mosebach, the managing partner, and Griffith both testified that at the partnership meeting held on July 25, 1977, Stevenson was not expelled for cause, but was given a choice to either voluntarily withdraw from the partnership or be expelled for cause. However, Mosebach admitted that he thought Stevenson could have been expelled for cause. They also stated that Stevenson did not immediately make a choice, but that two or three days later, he told Griffith that he wanted to set up his own practice and needed a client base. Thus, according to their version of the facts, Stevenson voluntarily withdrew from the partnership, and therefore was entitled to guaranteed payments provided under the partnership agreement. Ensuing negotiations purportedly involved Stevenson's acquisition of the right to service certain partnership clients. According to Mosebach, Stevenson prepared the client list containing the 1976 billings for listed clients to enable the parties to determine an appropriate purchase price for those clients. Mosebach testified that at the August 23rd meeting, he and Stevenson agreed (1) to set the amount of such billings at $117,200,[8] (2) to set the purchase price for the clients at 200 percent of this amount, or $234,400, and (3) to offset the guaranteed payments the partnership purportedly owed Stevenson in the amount of $234,401 against the purchase price, thereby effectively canceling out the two obligations. The 200 percent of prior year billings formula was derived from the liquidated damages provision of the partnership agreement, which required a former partner to pay the partnership as liquidated damages 200 percent of prior year billings of any partnership client lost due to the partner's breach of the agreement's noncompetition clause.

To support the above testimony, Griffith and Nielsen offered Mosebach's notes from the August 23rd meeting and a letter he sent to all of the partners after Stevenson's departure was complete. Mosebach's notes consist of nine points, the third of which is as follows: "List of clients WES wants to serve. Marvin Winick - Philosophy. Wash list with guaranteed payments." Mosebach's letter to the other partners, dated September 7, 1977, stated: "Enclosed are copies of the AGREEMENT and ASSIGNMENT which terminate Wayne Stevenson's interest in the Partnership. The clients released offset in total Wayne's guaranteed payments." Stevenson argues that this evidence of the alleged oral agreement violates the parol evidence rule because the alleged oral agreement contradicts or varies the terms of the separation agreement.

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[8] The total 1976 billings, as indicated on the client list, were $109,919.

The so-called parol evidence rule is a misnomer; the rule is one of substantive law and not one of evidence. Estate of Craft v. Commissioner, 68 T.C. 249, 262-263 (1977) (Court reviewed), affd. per curiam 608 F.2d 240 (5th Cir. 1979); 9 Wigmore, Evidence, sec. 2400, p. 4 (Chadbourn rev. 1981); 3 Corbin, Contracts, sec. 573, pp. 357-358 (1960); 4 Williston, Contracts, sec. 631, p. 956 (3d ed. 1961); 2 Restatement, Contracts 2d, Comment a. to sec. 213, p. 129 (1981). This Court has followed two approaches in applying the parol evidence rule. In cases concerning the proper allocation or character of amounts paid under a contract, we have held that "because respondent was not a party to the instrument involved, neither he nor petitioner may successfully rely on the rule to exclude extrinsic evidence offered by the other." Estate of Craft v. Commissioner, supra, 68 T.C. at 260, 263, and cases cited therein. However, in cases requiring a determination of legal rights and property interests under state law, we follow the applicable state parol evidence rule. Estate of Craft v. Commissioner, supra, 68 T.C. at 261-263, and cases cited therein. Here, we must determine the terms and conditions of Stevenson's departure from the partnership and the legal rights and property interests resulting therefrom. Thus, we apply Iowa's parol evidence rule in determining the admissibility of evidence regarding the alleged oral agreement.

Stevenson argues that such evidence violates Iowa's rule, relying on the holding of the Iowa Supreme Court in Montgomery Properties v. Economy Forms, 305 N.W.2d 470, 476 (Iowa 1981) that:

> [W]here the handcrafted contract contains an integration clause, where the parties were sophisticated business persons represented by counsel and of equal bargaining strength, and where terms of the alleged oral agreement reasonably would be expected to be included in the * * * agreement, [the] trial court did not err in sustaining a parol evidence rule objection, thus excluding evidence to vary its terms.

Thus we must determine whether the three requirements enumerated by the Iowa Supreme Court in Montgomery Properties have been satisfied.

First, the written contract must contain an integration clause. Griffith and Nielsen point out that the written contract in Montgomery Properties v. Economy Forms, supra, 305 N.W.2d at 472, specifically stated that it "supersedes any contracts or Offers to Buy and Sell Real Estate which may previously have been executed." They argue that the separation agreement does not contain an express statement that it supersedes all prior negotiations between the parties, and therefore does not satisfy this first requirement.

We do not think the Iowa Supreme Court intended the requirement to be construed so narrowly. In the same paragraph containing its definition of the parol evidence rule, the Iowa Supreme Court stated that "[a]n integrated agreement is one in which the parties adopt a writing or writings as the final and complete expression of the agreement." Montgomery Properties v. Economy Forms, supra, 305 N.W.2d at 476. See Kitchen v. Stockman National Life Insurance Co., 192 N.W.2d 796, 800 (Iowa 1971); 2 Restatement, Contracts 2d, sec. 209, p. 115 (1981); 3 Corbin, Contracts, sec. 588, pp. 520-530 (1960).[9]

Of course, extrinsic evidence of the alleged oral agreement is admissible to show that the separation agreement is not an integration. Montgomery Properties v. Economy Forms, supra, 305 N.W.2d at 476, and cases cited therein. See 9 Wigmore, Evidence, sec. 2430(2), p. 98-99 (Chadbourn rev. 1981). However, as noted in our findings of fact (n.4, supra), we found Stevenson to be a more credible witness than Mosebach and Griffith and, as will be discussed more fully below, his testimony and other evidence convince us that there was no agreement other than the separation agreement (and related assignment agreement) between Stevenson and the partnership.[10] Moreover, the separation agreement's recitals specifically state that in it "the parties desire to set forth their agreement with respect to the terms and conditions of [Stevenson's] termination." In addition, the first paragraph of the agreement explicitly provides that "[t]he parties further agree that except as provided for in this Agreement, neither party shall have any further liability or obligation whatsoever to the other party * * *." This plain language evidences the parties' clear intent to set forth all the terms of Stevenson's termination, and therefore constitutes an integration clause. Thus, the first requirement of the Iowa parol evidence rule is satisfied. We think this result clearly comports with the purpose of the parol evidence rule:

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[9] A written contract is presumed to embody all of the parties' agreements. In Re Simplot's Estate, 215 Iowa 578, 246 N.W. 396, 398 (1933). See 9 Wigmore, Evidence, sec. 2430(3), p. 99 (Chadbourn rev. 1981) ("If it is mentioned, covered, or dealt with in the writing, then presumably the writing was meant to represent all of the transaction on that element.") Moreover, the execution of a written agreement makes inoperative all contemporaneous oral agreements relating to the same subject matter, and such contemporaneous oral agreements cannot thereafter be used to add to or vary the written agreement. Weik v. Ace Rents, Inc., 249 Iowa 510, 87 N.W.2d 314, 318 (1958). See 2 Restatement, Contracts 2d, sec. 213, p. 129 (1981).

> [W]hen the parties have discussed and agreed upon their obligations to each other and reduced those terms to writing, the writing, if clear and unambiguous, furnishes better and more definite evidence of what was undertaken by each party than the memory of man * * *. The rule rests upon a rational foundation of experience and policy and is *essential to the certainty and stability of written obligations*. It is designed to permit a party to a written contract to *protect himself against perjury, infirmity of memory, or the death of witnesses*. [*Montgomery Properties v. Economy Forms, supra*, 305 N.W.2d at 476, quoting 30 Am.Jur.2d Evidence sec. 1016, at 151-152 (1967). (Emphasis supplied by the Iowa Supreme Court.)]

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[10] Although Mosebach is not a party to this case, he is a partner in the partnership and will be affected by our decision to the same extent as Griffith and Nielsen. While a statutory notice of deficiency has not yet been issued to Mosebach, he apparently has agreed to be bound by the outcome of this case.

Griffith and Nielsen argue that the separation agreement is not an integration because the following emphasized language of the separation agreement's first paragraph implies, they say, that there was some prior agreement, i.e., the alleged oral agreement, between the parties:

> The parties further agree that except as provided for in this Agreement, neither party shall have any further liability or obligation whatsoever to the other party and all rights and obligations of Stevenson under the Partnership's partnership agreement including, but not limited to, Stevenson's right to receive any further remuneration or guaranteed payments from the Partnership are terminated as of the "termination date". [Emphasis added.]

Their argument strains our credulity. A much more reasonable interpretation is that "further" in the first underscored phrase refers back to the "except as provided for in this Agreement" language immediately preceding it, and that "further" in the second underscored phrase refers to the draws Stevenson received from the partnership before his departure. In the context of the dispute raging between Stevenson and the partnership, we cannot believe that every detail of the minor agreement as to his capital account, accounts receivable, and work-in-process was carefully hammered out and documented, but the major agreement as to guaranteed payments was the subject of an oral agreement. To suggest that the one word "further" shows the existence of such an alleged oral agreement is to distort plain English.

The second requirement under Montgomery Properties is that the parties are sophisticated business persons represented by counsel with equal bargaining strength. Both Mosebach, the partnership's managing partner and chief negotiator, and Stevenson are certified public accountants with a great deal of business and tax experience. Stevenson and the partnership were both represented by counsel. Winick, Stevenson's counsel, drafted the separation agreement, and Sullivan, the partnership's counsel, reviewed it for the partnership. There is no evidence that either the partnership or Stevenson had a bargaining advantage over the other. Thus, the second requirement is satisfied.

Finally, the terms of the alleged oral agreement must reasonably be expected to be included in the written contract. Under the alleged oral agreement, Stevenson and the partnership purportedly agreed to offset Stevenson's alleged right to guaranteed payments in the amount of $234,401 with Stevenson's alleged obligation to pay the partnership such amount as the purchase price for certain partnership clients. The written separation agreement states that "[i]t is understood and agreed that Stevenson * * * will be rendering professional services to certain present clients of the Partnership listed on Schedule A attached hereto." The clients so listed are the clients Griffith and Nielsen allege Stevenson purchased. The separation agreement also provides that "[t]he parties agree to cooperate with each other in * * * connection with the transition of Partnership clients to Stevenson as contemplated hereunder." Thus, the separation agreement clearly contemplates that Stevenson would be providing accounting services to the purportedly purchased clients. Yet this written separation agreement makes no mention of any purchase of clients. The only purchase mentioned is Stevenson's purchase of certain clients' accounts receivable and work-in-process, the $61,146.10 price for which Stevenson paid by offsetting his capital account and expense reimbursements due in the amount of $60,212.55 and delivering to the partnership his check for the difference ($933.55). We cannot and do not believe that the parties would so specifically set forth their agreement as to accounts receivable and work-in-process valued at $61,146.10 and not include in the same document their agreement as to guaranteed payments in the amount of $234,401, almost four times as much money. The acrimonious nature of Stevenson's departure further justifies our disbelief of such an improbable scenario. Because of the interrelationship of any such guaranteed payments with the whole subject of the separation agreement and the amount of money involved, we would reasonably expect the terms of the alleged oral agreement to be included in the separation agreement.

All three of its requirements having been met, the Iowa Supreme Court's holding in Montgomery Properties dictates that all evidence concerning the alleged oral agreement be excluded under the parol evidence rule. Nonetheless, Griffith and Nielsen argue that any one of three exceptions to the parol evidence rule require that the evidence be admitted.

In *In Re Simplot's Estate*, 215 Iowa 578, 246 N.W. 396, 398 (1933), the Iowa Supreme Court set forth five exceptions to the parol evidence rule. One exception (the third listed in *Simplot's Estate*) is that an oral contract may be proved by extrinsic evidence if it (1) is contemporaneous with the written contract, (2) is purely collateral to the written contract, (3) is complete in itself, (4) does not contradict or vary any of the written contract's terms, and (5) stands upon its own terms and consideration. *In Re Simplot's Estate*, *supra*, 246 N.W. at 398. Griffith and Nielsen argue that the alleged oral agreement satisfies these requirements.

As demonstrated above, the written separation agreement evidences the parties' clear intent to set forth *all* the terms of Stevenson's termination. Thus, Griffith and Nielsen's contention that there are other terms and conditions of Stevenson's termination in itself contradicts the separation agreement. As also noted earlier, the separation agreement clearly contemplates that Stevenson would be servicing listed clients, the same clients Stevenson purportedly purchased under the alleged oral agreement. Yet the separation agreement makes no mention of any such purchase. Griffith and Nielsen's assertion that Stevenson purchased these clients under the alleged oral agreement at least varies the terms of the separation agreement. Thus, this exception is of no avail to them.

A second exception to the parol evidence rule (the fifth listed in Simplot's Estate) is that a single contract may be expressed partly in writing and partly in parol. In Re Simplot's Estate, supra, 246 N.W. at 398. "However, a written contract is presumed to be complete and to comprise the entire transaction unless it otherwise appears from the written terms of the contract itself." In Re Simplot's Estate, supra, 246 N.W. at 398. Griffith and Nielsen argue that language in the separation agreement suggests the existence of other terms of the agreement.[11] They reiterate their assertion that use of the word "further" in the separation agreement's first paragraph is an "obvious" reference to the alleged oral agreement. We disagree. We need not repeat our reasons for rejecting this contrived argument. The separation agreement on its face precludes application of this exception.

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[11] We note the inconsistency of this position with Griffith and Nielsen's constant characterization of the alleged oral agreement and the separation agreement as two separate and independent contracts. They make no effort to reconcile these contradictory approaches except to say that because the separation agreement contains no integration clause and refers to other terms, it does not matter whether the alleged oral agreement is considered a separate agreement or part of a larger agreement expressed partly in writing and partly in parol. Because we disagree with both premises, we need not address this inconsistency.

Finally, Griffith and Nielsen argue that a third exception adopted by the Iowa Supreme Court in Gordon v. Witthauer, 258 Iowa 617, 138 N.W.2d 918, 921 (1965), quoting Wise v. Quina, 174 So.2d 590, 597 (Fla. Dist. Ct. App. 1965), applies:

> A written contract or agreement may be altered or modified by an oral agreement if the latter has been accepted and acted upon by the parties in such manner as would work a fraud on either party to refuse to enforce it. * * *

Griffith and Nielsen contend that in reliance upon the alleged oral agreement, the partnership relinquished its right to perform future accounting services for listed clients and that Stevenson accepted the benefit of that transfer. They further argue that immediately after the agreement was reached, Stevenson began soliciting release forms from those clients so that he could obtain their files from the partnership. Thus, Griffith and Nielsen continue, Stevenson accepted and acted upon the alleged oral agreement and to refuse to enforce it would work a fraud on them.

To support their theory, Griffith and Nielsen point out that Stevenson sought and delivered release forms to the partnership before the separation agreement was signed. They deduce from this fact that Stevenson sought such release forms pursuant to the alleged oral agreement. However, they did not challenge, and now ignore, Stevenson's testimony (which we accepted) that he submitted release forms for many of the clients at the August 23rd meeting at which the alleged oral agreement was purportedly entered into. Thus, Stevenson sought release forms before, not in reliance upon, the alleged oral agreement. The fact that Stevenson presented such forms to the partnership before the separation agreement was signed does not show that he acted on the alleged oral agreement and should be bound by it under this third exception to the parol evidence rule.

In sum, the requirements for application of the parol evidence rule set forth by the Iowa Supreme Court in Montgomery Properties, supra, have been satisfied. Moreover, none of the exceptions urged by Griffith and Nielsen applies. Therefore, all evidence of the alleged oral agreement could properly be excluded. However, even if such evidence is considered, we conclude that it does not establish the existence of the alleged oral agreement.

In any event, resolution of this case depends on whose version of the facts we accept. According to Stevenson, the written separation agreement contained all the terms and conditions of his termination from the partnership, and by executing the separation agreement, the parties in effect tore up the partnership agreement and relinquished their respective rights under it. Mosebach, on the other hand, claimed that the partnership agreement was still in effect and that in addition to executing the separation agreement, the parties orally agreed to offset guaranteed payments due to Stevenson in the amount of $234,401 with the price he was to pay for partnership clients in the same amount.

The written separation agreement supports Stevenson's testimony. It contains language to the effect that it is the exclusive agreement between the parties regarding Stevenson's departure from the partnership. It also negates Stevenson's rights and obligations under the partnership agreement, including his right to receive any further remuneration or guaranteed payments from the partnership. The agreement acknowledges that Stevenson would be performing accounting services for certain partnership clients listed in Schedule A to the agreement. It makes no mention of any purchase or sale of such clients. Griffith and Nielsen repeat their tenuous argument that use of the word "further" in strategic places in the separation agreement amounts to an acknowledgement of the alleged oral agreement. We reject this argument for the reasons indicated above.

As the Court stated at trial, it has difficulty believing that these two warring factions memorialized a $61,000 aspect of Stevenson's termination and did not memorialize a $234,401 aspect. In fact, the Court simply does not believe it. Griffith and Nielsen argue that the separation agreement was silent about the alleged oral agreement because Stevenson's counsel, Winick, was the draftsman. They suggest rather invidiously that Winick did not put the alleged oral agreement's terms in the separation agreement because he did not want to leave a "paper trail" for the Internal Revenue Service. However, Mosebach testified that during the negotiations, he knew that Stevenson would not agree to the tax consequences sought by the partnership regarding an offset of guaranteed payments and client purchase price. Mosebach admitted that an attempt to confirm the offset in writing could have ended the negotiations. Thus, Griffith and Nielsen in effect are arguing that the alleged oral agreement was entered into, but not set forth in writing, because Stevenson would not agree to the tax consequences that would clearly flow from it. We think this amply demonstrates the lack of factual support for Griffith and Nielsen's position. Mosebach testified that he considered the alleged oral agreement's tax consequences controlled by the partnership agreement. Before the tax consequences could arise, however, there had to be an oral agreement to purchase clients and to offset guaranteed payments against client purchase price. We are unconvinced that such an agreement was made. We believed Stevenson's testimony that there was no such agreement. Mosebach's position on this point, and the other partners' overall position in this litigation, is premised on the existence of such an oral agreement and the partnership agreement's continuing to govern Stevenson's termination. Again, we disagree.

We have found as a fact that the partnership expelled Stevenson for cause. Under the partnership agreement this negated his right to guaranteed payments and other rights in the partnership. The parties by their written separation agreement in effect tore up the partnership agreement, and Mosebach's continued reliance on it is misplaced. The separation agreement specifically states that "all rights and obligations of Stevenson under the Partnership's partnership agreement are terminated." In the state court litigation, the Iowa District Court for Polk County held that the separation agreement was a novation of the partnership agreement.[12] Moreover, Mosebach himself, in a letter to Stevenson shortly after the separation agreement was signed, described Stevenson's termination as being "completely outside the provisions of our Partnership Agreement." That letter also stated that Stevenson was allowed to withdraw clients. It said nothing about a purchase of clients for $234,401 or offsetting guaranteed payments against such purported purchase price.

Furthermore, even the purported terms of the alleged oral agreement demonstrate a total disregard for the partnership agreement. The partnership agreement clearly does not permit the sale of partnership clients to departing partners. It requires the payment of liquidated damages by a former partner who provides accounting services to former partnership clients. In addition, the partnership agreement required the partnership to pay Stevenson his guaranteed payments in monthly, noninterest-bearing installments over 20 years. Under the alleged oral agreement, the guaranteed payments were accelerated in one payment as an offset against the purchase price for partnership clients. Thus, it is abundantly clear that the terms of Stevenson's termination were outside and wholly contrary to the provisions of the partnership agreement.

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[12] While we are not bound by this holding, we certainly have no quarrel with it.

Other factors also lead us to accept Stevenson's testimony as opposed to that of Mosebach and Griffith. The partnership did not claim a deduction for the alleged guaranteed payments on the line of its return specifically designated therefor. Instead, the deduction was lumped with other items under "Other Deductions" and listed with those other items on a schedule attached to the return. In addition, the partnership did not include any guaranteed payments on the schedule K-1 it prepared for Stevenson. Mosebach admitted that these omissions were intentional and defended them by saying that they were made because the partnership was involved in state court litigation with Stevenson, and the partners, primarily Nielsen and Mosebach, made a "professional judgment" not to include the alleged guaranteed payments on Stevenson's schedule K-1. We found this explanation disingenuous, to say the least. Griffith and Nielsen argue that the partnership's reporting position is inconsequential because Stevenson was not misled by the absence of the guaranteed payment on his schedule K-1. We disagree. The schedule K-1 was intentionally misleading, and Stevenson was misled. Stevenson received the schedule K-1 and found it wholly consistent with the facts and with his understanding of the transaction. He prepared his tax return based on that schedule K-1; the partnership and the other partners prepared their returns on an inconsistent basis; hence, this litigation. Stevenson did not see the partnership return until he was audited and received a copy of it from the Internal Revenue Service. The partnership intentionally "buried" the deduction on its return, and thus in effect tried to hide it from Stevenson and the Internal Revenue Service.

There is also evidence that the alleged oral agreement theory developed rather recently. In a letter to the auditing agent dated October 24, 1979, Mosebach stated that the negotiations for Stevenson's purchase of clients resulted in the separation agreement. In addition, the petitions of both Griffith and Nielsen in this case allege that Stevenson "wished to purchase certain clients from the firm. An agreement was reached with respect to his wishes and made a part of the [separation] Agreement." (Emphasis added.)

The above factors outweigh any problem we have with Stevenson's testimony. During the state court litigation, Stevenson apparently testified that he purchased certain clients or accounts from the partnership. See n.7, supra. At the trial in this case, Stevenson claimed that these statements were made based on the premise that the partnership agreement was still in effect and that in using the term purchase he was referring to liquidated damages that the partnership agreement required from a former partner for breaching its noncompetition clause. Griffith and Nielsen argue that we should rely on these previous statements in rejecting Stevenson's denial of the purchase and offset. They point out that in its opinion, the Iowa District Court for Polk County stated: "The Court has considered that Wayne E. Stevenson admitted having paid 200% of a year's services or billings as consideration for the list of clients he took with him." However, the District Court also stated that "there is no further evidence of payment [by Stevenson] beyond $61,146.10," the amount he paid for the accounts receivable. In addition, there is no indication that Stevenson ever admitted agreeing to offset a purchase price for clients with guaranteed payments or otherwise receiving any guaranteed payments from the partnership. Thus, while we find Stevenson's prior testimony rather garbled and somewhat troubling, we have primarily relied upon the sworn testimony in this Court. Here we had the opportunity to observe the demeanor of the witnesses and to make our own determinations as to credibility. Diaz v. Commissioner, 58 T.C. 560, 564 (1972).

Griffith and Nielsen contend that other evidence fully supports Mosebach's testimony regarding the alleged oral agreement. They argue that we should accept Mosebach's testimony because it is fully corroborated by the notes he took during the August 23rd meeting. However, those notes at best represent Mosebach's impressions of the negotiations that took place at the meeting. The notes provide no evidence that they are terms of an agreement by the parties. Some of the points made in the notes were incorporated into the separation agreement. Other points, according to Griffith and Nielsen, evidence the existence of the alleged oral agreement. The notes also contain points that not even Griffith and Nielsen argue were agreed upon. In short, Mosebach's notes are not probative evidence that the alleged oral agreement was made.[13]

Griffith and Nielsen point to a letter Mosebach wrote to the other partners dated September 7, 1977, which states "[t]he clients released offset in total [Stevenson's] guaranteed payments." They argue that this statement is further evidence of the alleged oral agreement. However, the letter represents Mosebach's unilateral statement to his partners of his version of what took place. There is no evidence that Stevenson acquiesced in Mosebach's characterization. He testified he did not, and we believed him.

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[13] Griffith and Nielsen suggest that this Court should draw some adverse inference from the fact that Winick's notes of that meeting were not offered. The record does not show that any such notes were in existence, and if those petitioners wanted the notes (if extant), they should have used the discovery procedures of this Court to try to obtain them and not ask this Court to speculate as to what, if anything, such notes (if they exist) may show. Actually, since the written separation agreement was thereafter executed, we think any notes of preliminary negotiations would have little or no probative value. The fact that the written separation agreement thereafter executed is silent about matters contained in Mosebach's notes convinces the Court that if those matters were discussed at the meeting with Stevenson and his attorney, they were rejected by them, not made the subject of an oral agreement.

Griffith and Nielsen contend that Stevenson included the 1976 gross billings on the draft of the client list that became the first Schedule A to the separation agreement so that he and the partnership could calculate the purchase price for the listed clients. However, Stevenson stated that he included the billing figures only because Mosebach requested them. More importantly, that client list became the first Schedule A to the separation agreement, which was the list of clients whose accounts receivable and work-in-process Stevenson purchased. The second Schedule A to the agreement, according to Mosebach, lists the clients Stevenson allegedly purchased. However, the draft thereof did not state the clients' billings. Thus, there is no evidence that the parties calculated the total 1976 billings for all clients allegedly sold to Stevenson so that a purchase price could be determined. In addition, the separation agreement provides, and Stevenson testified, that the second Schedule A was attached to the separation agreement simply to identify the clients for which Stevenson was to provide release forms in order to obtain their files from the partnership.

Griffith and Nielsen argue that the purchase price was determined by taking 200 percent of the 1976 billings for clients purchased. However, those clients' 1976 billings, as shown on the draft client list, totaled only $109,919. Two hundred percent of that number yields a purchase price of $219,838. Griffith and Nielsen offered no probative evidence and only weak explanations of why the over $14,000 difference between the calculated purchase price and Stevenson's alleged guaranteed payments in the amount of $234,401 was ignored by the parties. The lack of evidence or plausible explanation is especially damaging because the partnership required Stevenson to pay the $933.55 difference between the agreed price for the accounts receivable he purchased and his capital account, which was offset against such purchase price. In addition, Stevenson testified, and we have found as a fact, that the 1976 billings for clients he anticipated actually remaining with him were only between $75,000 and $80,000.

Griffith and Nielsen also contend that the partnership would not simply allow Stevenson to take a number of partnership clients without receiving consideration therefor and that Stevenson would not just "walk away" from $234,401 in guaranteed payments. They argue that clients were considered clients of the partnership and not of particular partners. This, they continue, is why Stevenson received vested guaranteed payments in the amount of $91,142 upon joining the partnership. We have amply demonstrated above that the parties disregarded the partnership agreement in negotiating Stevenson's departure. We also think that the partnership had little control over the clients Stevenson took with him. He was the only person in the partnership who knew anything about those clients. The partnership would not have retained most of them regardless of whether Stevenson took them with him. Mosebach admitted that the partnership was not interested in retaining several of these clients. Moreover, Stevenson's "vested" guaranteed payments were unfunded, and he considered them of little value when compared with the money he could make by practicing on his own. He understandably was not interested in trading his professional career and future livelihood for monthly guaranteed payments in the amount of about $975 for 20 years. Lastly, the partnership terminated Stevenson for cause, and he was not entitled to any guaranteed payments. Thus, we reject Griffith and Nielsen's argument on this point.

In summary, based on the record as a whole, we find the evidence supporting Stevenson's version of the facts more persuasive, and accept it. Thus, we hold that Stevenson did not receive any guaranteed payments from the partnership in connection with his termination therefrom.

To reflect the foregoing,[14]

Decision will be entered for petitioners in docket No. 15671-81.

Decisions will be entered under Rule 155[15] in docket Nos. 10897-82 and 10898-82.

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[14] Petitioners in all three dockets requested in their petitions that we award them attorneys fees. Stevenson filed his petition on June 30, 1981. Griffith and Nielsen filed their petitions on May 21, 1982. Thus, we have no jurisdiction to award such fees in this case. *McQuiston v. Commissioner*, 78 T.C. 807 (1982), affd. without published opinion 711 F.2d 1064 (9th Cir. 1983). Under section 7430, added to the Code by section 292(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, 96 Stat. 324, 572, 1982-2 C.B. 462, 546-547, we have authority to award reasonable litigation costs to a "prevailing party" in a proceeding commenced in this Court after February 28, 1983. See also Rules 230-233. However, Rule 34 in pertinent part provides that "[a] claim for reasonable litigation costs *shall not be included in the petition* in a deficiency or liability action." (Emphasis added.) In general, under Rule 231, the time for making such claims is *after* the substantive issues have been resolved.

Here, the Court finds it rather ironic that petitioners seek to recover their litigation costs from respondent. Respondent is a disinterested stakeholder in this matter. These lawsuits resulted from the partners' own internal partnership squabbles and the partners' inconsistent treatment on their tax returns of the purported guaranteed payments. While Stevenson may have been an innocent victim, respondent was not responsible for his plight.

[15] In their Reply Brief, Griffith and Nielsen for the first time raise alleged computational errors in their notices of deficiency based on respondent's failure to use income averaging, to reduce their capital gains for their allocable shares of the capital gain the partnership reported from the alleged sale of clients to Stevenson, and to properly compute automatic adjustments. We will not consider matters raised for the first time on brief. *Neely v. Commissioner*, 85 T.C. 934, 943-944 (1985). However, if there are purely computational errors, the parties will be given an opportunity to try to resolve them in their Rule 155 computations.